Internal Revenue
bulletin

Bulletin No. 2012-8
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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

T.D. 9565, page 378.
REG–124627–11, page 417.

Final, temporary, and proposed regulations under section 368 of the Code provide guidance regarding the continuity of interest requirement for corporate reorganizations. The guidance is necessary to establish the date upon which continuity of interest is measured. The regulations affect corporations and their shareholders.

T.D. 9567, page 395.
REG–130302–10, page 412.

Temporary and proposed regulations under section 6038D of the Code provide guidance relating to the requirement that individuals attach a statement to their income tax return to provide required information regarding foreign financial assets in which they have an interest. The notice of proposed rulemaking also includes a proposed regulation setting forth requirements for certain domestic entities to report foreign financial assets in the same manner as an individual.

Notice 2012–14, page 411.

This notice addresses whether individuals who are eligible for services at an Indian Health Service facility are also eligible individuals for purposes of contributing to a Health Savings Account (HSA) under section 223 of the Code.

EMPLOYEE PLANS

Rev. Rul. 2012–3, page 383.

Application of survivor annuity requirements to deferred annuity contracts under a defined contribution plan. This ruling describes how the qualified joint and survivor annuity ("QJSA") and the qualified preretirement survivor annuity ("QPSA") rules, described in sections 401(a)(11) and 417 of the Code, apply when a deferred annuity contract is purchased under a profit-sharing plan.

Rev. Rul. 2012–4, page 386.

Rollover from qualified defined contribution plan to qualified defined benefit plan to obtain additional annuity. This ruling describes whether a qualified defined benefit pension plan that accepts a direct rollover of an eligible rollover distribution from a qualified defined contribution plan maintained by the same employer satisfies sections 411 and 415 of the Code in a case in which the defined benefit plan provides an annuity resulting from the direct rollover.

EMPLOYMENT TAX

T.D. 9566, page 389.

Final regulations under sections 6011 and 6302 of the Code provide guidance relating to the annual filing of federal employment tax returns and requirements for employment tax deposits. The regulations concern reporting and paying income taxes withheld from wages and reporting and paying taxes under the Federal Insurance Contributions Act (FICA) (collectively, "employment taxes"). The regulations generally allow certain employers to file a Form 944, *Employer's ANNUAL Federal Tax Return*, rather than Form 941, *Employer's QUARTERLY Federal Tax Return*.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

Section 368.—Definition Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

T.D. 9565

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the continuity of interest requirement for corporate reorganizations. The guidance is necessary to establish the date upon which continuity of interest is measured. These regulations affect corporations and their shareholders.

DATES: *Effective Date:* These regulations are effective on December 19, 2011.

Applicability Date: For dates of applicability, see §1.368–1(e)(9)(ii).

FOR FURTHER INFORMATION CONTACT: Richard Starke at (202) 622–7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The Internal Revenue Code of 1986 (Code) provides for general non-recognition treatment for reorganizations described in section 368 of the Code. In addition to satisfying the statutory requirements of a reorganization, a transaction also must satisfy certain non-statutory requirements, such as continuity of interest (COI). COI requires that, in substance, a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. A proprietary interest in the target corporation is preserved if, in a potential reorganization, it is exchanged for a proprietary interest in the issuing corporation, it is exchanged by the acquiring corporation for a direct interest in the target corporation enterprise, or it otherwise continues as a proprietary interest in the target corporation. See §1.368–1(e)(1)(i).

On August 10, 2004, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–129706–04, 2004–2 C.B. 479) in the **Federal Register** (69 FR 48429) (2004 proposed regulations) identifying certain circumstances in which the determination of whether a proprietary interest in the target corporation is preserved would be made by reference to the value of the issuing corporation's stock on the day before there is an agreement to effect the potential reorganization. Specifically, the 2004 proposed regulations provided that, in determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation pursuant to a contract to effect the potential reorganization is valued on the last business day before the first date such contract is a binding contract (the Pre-Signing Date), if such consideration was fixed at the signing date (the signing date rule). On September 16, 2005, the IRS and the Treasury Department published final regulations (T.D. 9225, 2005–2 C.B. 716) in the **Federal Register** (70 FR 54631) (2005 final regulations) that retained the general framework of the 2004 proposed regulations but made several modifications in response to comments received regarding the proposed regulations. After consideration of comments relating to the 2005 final regulations, the IRS and the Treasury Department published temporary (T.D. 9316, 2007–1 C.B. 962) and proposed (REG–146247–06, 2007–1 C.B. 977) regulations in the **Federal Register** (72 FR 12974 and 72 FR 13058 respectively) (the 2007 temporary regulations). The 2007 temporary regulations generally narrowed the definition of fixed consideration, and accordingly, limited the application of the signing date rule. The preamble explained that the signing date rule is based on the principle that, where a binding contract provides for fixed consideration, the target corporation shareholders can generally be viewed as being subject to the economic fortunes of the issuing corporation as of the signing date. However, if the contract does not provide for fixed consideration, the signing date value of the issuing corporation stock is not relevant for purposes of determining the extent to which a proprietary interest in the target corporation is preserved.

On March 17, 2010, the IRS released Notice 2010–25 (the notice), 2010–14 I.R.B. 527. Notice 2010–25 acknowledged that the 2007 temporary regulations would, as required by sunset provisions of section 7805(e)(2), expire on March 19, 2010. It also noted that proposed regulations (REG–146247–06, 2007–1 C.B. 977) previously published in the **Federal Register** (72 FR 13058) had the same text as the expiring temporary regulations and would remain outstanding after that expiration. The notice provided that, until the issuance of new regulations, taxpayers could choose, as long as a specified condition of consistency among parties was satisfied, to apply the rules in the proposed regulations. The ability of taxpayers to elect to apply the rules of the proposed regulations, as provided in the notice, is incorporated into §1.368–1(e)(9)(ii), the effective/applicability date of these final regulations. See §601.601(d)(2)(ii)(*b*).

Explanation of Revisions

These final regulations adopt the 2007 temporary regulations with only minor changes. First, questions were raised concerning whether a contract can provide for fixed consideration under the general definition of fixed consideration if the contract provides for a shareholder election. These final regulations clarify that a shareholder election does not prevent a contract from satisfying the general definition of fixed consideration if that requirement is otherwise met. Second, *Example 9* is modified to address a more typical fact pattern.

In response to comments regarding the application of the signing date rule and after further consideration of the purpose and operation of that rule, the IRS and the Treasury Department have proposed a regulation, published elsewhere in this issue of the Bulletin, under which application of the signing date principles would be expanded. That notice of proposed rulemaking (REG–124627–11) also requests comments regarding the propriety of applying signing date principles more generally to transactions in which the target corporation shareholders, pursuant to a binding contract to effect a potential reorganization, become subject to the economic fortunes of issuing corporation consideration between the signing date and the closing date. In these cases, a more liberal application of signing date principles may result in valuing issuing corporation consideration at one or more dates between the signing date and the closing date.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13565. 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 this regulation and, because the regulation does not impose a collection of information on small entities, 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, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these final regulations is Richard Starke of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.368–1 is amended by revising paragraph (e)(2), revising the paragraph heading of (e)(9)(i), and revising paragraph (e)(9)(ii) to read as follows:

§1.368–1 Purpose and scope of exception of reorganization exchanges.

* * * * *

(e) * * *

(2) *Measuring continuity of interest*—(i) *In general*. In determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation pursuant to a contract to effect the potential reorganization shall be valued on the last business day before the first date such contract is a binding contract (the pre-signing date), if such contract provides for fixed consideration. If a portion of the consideration provided for in such a contract consists of other property identified by value, then this specified value of such other property is used for purposes of determining the extent to which a proprietary interest in the target corporation is preserved. If the contract does not provide for fixed consideration, this paragraph (e)(2)(i) is not applicable.

(ii) *Binding contract*—(A) *In general*. A binding contract is an instrument enforceable under applicable law against the parties to the instrument. The presence of a condition outside the control of the parties (including, for example, regulatory agency approval) shall not prevent an instrument from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, shall not prevent an instrument from being a binding contract.

(B) *Modifications*—(*1*) *In general*. If a term of a binding contract that relates to the amount or type of the consideration the target shareholders will receive in a potential reorganization is modified before the closing date of the potential reorganization, and the contract as modified is a binding contract, the date of the modification shall be treated as the first date there is a binding contract.

(*2*) *Modification of a transaction that preserves continuity of interest*. Notwithstanding paragraph (e)(2)(ii)(B)(*1*) of this section, a modification of a term that relates to the amount or type of consideration the target shareholders will receive in a transaction that would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification will not be treated as a modification if—

(*i*) The modification has the sole effect of providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders;

(*ii*) The modification has the sole effect of decreasing the amount of money or other property to be delivered to the target corporation shareholders; or

(*iii*) The modification has the effect of decreasing the amount of money or other property to be delivered to the target corporation shareholders and providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders.

(*3*) *Modification of a transaction that does not preserve continuity of interest*. Notwithstanding paragraph (e)(2)(ii)(B)(*1*) of this section, a modification of a term that relates to the amount or type of consideration the target shareholders will receive in a transaction that would not have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification will not be treated as a modification if—

(*i*) The modification has the sole effect of providing for the issuance of fewer shares of issuing corporation stock to the target corporation shareholders;

(*ii*) The modification has the sole effect of increasing the amount of money or other property to be delivered to the target corporation shareholders; or

(*iii*) The modification has the effect of increasing the amount of money or other property to be delivered to the target corporation shareholders and providing for the issuance of fewer shares of issuing corporation stock to the target corporation shareholders.

(C) *Tender offers*. For purposes of this paragraph (e)(2), a tender offer that is subject to section 14(d) of the Securities and Exchange Act of 1934 [15 U.S.C. 78n(d)(1)] and Regulation 14D (17 CFR 240.14d–1 through 240.14d–101) and is not pursuant to a binding contract, is treated as a binding contract made on the date of its announcement, notwithstanding that it may be modified by the offeror or that it is not enforceable against the offerees. If a modification (not pursuant to a binding contract) of such a tender offer is subject to the provisions of Regulation 14d–6(c) (17 CFR 240.14d–6(c)) and relates to the amount or type of the consideration received in the tender offer, then the date of the modification shall be treated as the first date there is a binding contract.

(iii) *Fixed consideration*—(A) *In general*. A contract provides for fixed consideration if it provides the number of shares of each class of stock of the issuing corporation, the amount of money, and the other property (identified either by value or by specific description), if any, to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation. A shareholder's election to receive a number of shares of stock of the issuing corporation, money, or other property (or some combination of stock of the issuing corporation, money, or other property) in exchange for all of the shareholder's proprietary interests in the target corporation, or each of the shareholder's proprietary interests in the target corporation, will not prevent a contract from satisfying the definition of fixed consideration provided for in this paragraph (e)(2)(iii)(A).

(B) *Shareholder elections*. A contract that provides a target corporation shareholder with an election to receive a number of shares of stock of the issuing corporation, money, or other property (or some combination of stock of the issuing corporation, money, or other property) in exchange for all of the shareholder's proprietary interests in the target corporation, or each of the shareholder's proprietary interests in the target corporation, provides for fixed consideration if the determination of the number of shares of issuing corporation stock to be provided to the target corporation shareholder is determined using the value of the issuing corporation stock on the last business day before the first date there is a binding contract. This is the case even though the shareholder election may preclude a determination, prior to the closing date, of the number of shares of each class of the issuing corporation, the amount of money, and the other property (or the combination of shares, money and other property) to be exchanged for each proprietary interest in the target corporation.

(C) *Contingent adjustments to the consideration*—(*1*) *In general*. Except as provided in paragraph (e)(2)(iii)(C)(*2*) of this section, a contract that provides for contingent adjustments to the consideration will be treated as providing for fixed consideration if it would satisfy the requirements of paragraph (e)(2)(iii)(A) of this section without the contingent adjustment provision.

(*2*) *Exceptions*. A contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the consideration that prevent (to any extent) the target corporation shareholders from being subject to the economic benefits and burdens of ownership of the issuing corporation stock after the last business day before the first date the contract is a binding contract. For example, a contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the consideration in the event that the value of the stock of the issuing corporation, the value of the assets of the issuing corporation, or the value of any surrogate for either the value of the stock of the issuing corporation or the assets of the issuing corporation increases or decreases after the last business day before the first date there is a binding contract. Similarly, a contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the number of shares of the issuing corporation stock to be provided to the target corporation shareholders computed using any value of the issuing corporation shares after the last business day before the first date there is a binding contract.

(D) *Escrows*. Placing part of the consideration to be exchanged for proprietary interests in the target corporation in escrow to secure target's performance of customary pre-closing covenants or customary target representations and warranties will not prevent a contract from being treated as providing for fixed consideration.

(E) *Anti-dilution clauses*. The presence of a customary anti-dilution clause will not prevent a contract from being treated as providing for fixed consideration. However, the absence of such a clause will prevent a contract from being treated as providing for fixed consideration if the issuing corporation alters its capital structure between the first date there is an otherwise binding contract to effect the transaction and the effective date of the transaction in a manner that materially alters the economic arrangement of the parties to the binding contract. If the number of shares of the issuing corporation to be issued to the target corporation shareholders is altered pursuant to a customary anti-dilution clause, the value of the shares determined under paragraph (e)(2)(i) of this section must be adjusted accordingly.

(F) *Dissenters' rights*. The possibility that some shareholders may exercise dissenters' rights and receive consideration other than that provided for in the binding contract will not prevent the contract from being treated as providing for fixed consideration.

(G) *Fractional shares*. The fact that money may be paid in lieu of issuing fractional shares will not prevent a contract from being treated as providing for fixed consideration.

(iv) *New issuances*. For purposes of applying paragraph (e)(2)(i) of this section, any class of stock, securities, or indebtedness that the issuing corporation issues to the target corporation shareholders pursuant to the potential reorganization and that does not exist before the first date there is a binding contract to effect the potential reorganization is deemed to have been issued on the last business day before the first date there is a binding contract to effect the potential reorganization.

(v) *Examples*. For purposes of the examples in this paragraph (e)(2)(v), P is the issuing corporation, T is the target corporation, S is a wholly owned subsidiary of P, all corporations have only one class of stock outstanding, A is an individual, no transactions other than those described occur, and the transactions are not otherwise subject to recharacterization. The following examples illustrate the application of this paragraph (e)(2):

Example 1. Application of signing date rule. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Twenty of the P shares, however, will be placed in escrow to secure customary target representations and warranties. The P stock is listed on an established market. On January 2 of year 1, the value of the P stock is $1 per share. On June 1 of year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is $.25 per share. None of the stock placed in escrow is returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. Because, for continuity of interest purposes, the T stock is exchanged for $40 of P stock and $60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 2. Treatment of forfeited escrowed stock. (i) Escrowed stock. The facts are the same as in *Example 1* except that T's breach of a representation results in the escrowed consideration being returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. Pursuant to paragraph (e)(1)(i) of this section, for continuity of interest purposes, the T stock is exchanged for $20 of P stock and $60 of cash, and the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

(ii) *Escrowed stock and cash*. The facts are the same as in paragraph (i) of this *Example 2* except that the consideration placed in escrow consists solely of eight of the P shares and $12 of the cash. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. Pursuant to paragraph (e)(1)(i) of this section, for continuity of interest purposes, the T stock is exchanged for $32 of P stock and $48 of cash, and the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 3. Redemption of stock received pursuant to binding contract. The facts are the same as in *Example 1* except that A owns 50 percent of the outstanding stock of T immediately prior to the merger and receives 10 P shares and $30 in the merger and an additional 10 P shares upon the release of the stock placed in escrow. In connection with the merger, A and S agree that, immediately after the merger, S will purchase any P shares that A acquires in the merger for $1 per share. Shortly after the merger, S purchases A's P shares for $20. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. In addition, S is a person related to P under paragraph (e)(4)(i)(A) of this section. Accordingly, A is treated as exchanging his T shares for $50 of cash. Because, for continuity of interest purposes, the T stock is exchanged for $20 of P stock and $80 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 4. Modification of binding contract—continuity not preserved. The facts are the same as in *Example 1* except that on April 1 of year 1, the parties modify their contract. Pursuant to the modified contract, which is a binding contract, the T shareholders will receive 50 P shares (an additional 10 shares) and $75 of cash (an additional $15 of cash) in exchange for all of the outstanding T stock. On March 31 of year 1, the value of the P stock is $.50 per share. Under this paragraph (e)(2), although there was a binding contract providing for fixed consideration as of January 3 of year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of year 1. The execution of the transaction without modification would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification. However, because the modified contract provides for additional P stock and cash to be exchanged for all the proprietary interests in T, the exception in paragraph (e)(2)(ii)(B)(*2*) of this section does not apply to preserve the original signing date. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on March 31 of year 1. Because, for continuity of interest purposes, the T stock is exchanged for $25 of P stock and $75 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 5. Modification of binding contract disregarded—continuity preserved. The facts are the same as in *Example 4* except that, pursuant to the modified contract, which is a binding contract, the T shareholders will receive 60 P shares (an additional 20 shares as compared to the original contract) and $60 of cash in exchange for all of the outstanding T stock. In addition, on March 31 of year 1, the value of the P stock is $.40 per share. Under this paragraph (e)(2), although there was a binding contract providing for fixed consideration as of January 3 of year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of year 1. Nonetheless, the modification has the sole effect of providing for the issuance of additional P shares to the T shareholders. In addition, the execution of the terms of the contract without regard to the modification would have resulted in the preservation of a substantial part of the value of the T shareholders' proprietary interest in T because, for continuity of interest purposes, the T stock would have been exchanged for $40 of P stock and $60 of cash. Pursuant to paragraph (e)(2)(ii)(B)(*2*) of this section, the modification is not treated as a modification for purposes of paragraph (e)(2)(ii)(B)(*1*) of this section. Accordingly, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. Because, for continuity of interest purposes, the T stock is exchanged for $60 of P stock and $60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore the transaction satisfies the continuity of interest requirement.

Example 6. New issuance. The facts are the same as in *Example 1*, except that, instead of cash, the T shareholders will receive a new class of P securities that will be publicly traded. In the aggregate, the securities will have a stated principal amount of $60 and bear interest at the average LIBOR (London Interbank Offered Rates) during the 10 days prior to the potential reorganization. If the T shareholders had been issued the P securities on January 2 of year 1, the P securities would have had a value of $60 (determined by reference to the value of comparable publicly traded securities). Whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock and the P securities to be issued to the T shareholders on January 2 of year 1. Under paragraph (e)(2)(iv) of this section, for purposes of valuing the new P securities, they will be treated as having been issued on the pre-signing date. Because, for continuity of interest purposes, the T stock is exchanged for $40 of P stock and $60 of other property, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 7. Fixed consideration—continuity not preserved. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. Pursuant to the contract, 60 shares of the T stock will be exchanged for $80 of cash and 40 shares of the T stock will be exchanged for 20 shares of P stock. On January 2 of year 1, the value of the P stock is $1 per share. On June 1 of year 1, T merges with and into P pursuant to the terms of the contract. This contract provides for fixed consideration and therefore whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. However, applying the signing date rule, the P stock represents only 20 percent of the value of the total consideration to be received by the T shareholders. Accordingly, based on the economic realities of the exchange, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 8. *Anti-dilution clause*. (i) *Absence of anti-dilution clause*. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. The contract does not contain a customary anti-dilution provision. The P stock is listed on an established market. On January 2 of year 1, the value of the P stock is $1 per share. On April 10 of year 1, P issues its stock to effect a stock split; each shareholder of P receives an additional share of P for each P share that it holds. On April 11 of year 1, the value of the P stock is $.50 per share. Because P altered its capital structure between January 3 and June 1 of year 1 in a manner that materially alters the economic arrangement of the parties, under paragraph (e)(2)(iii)(E) of this section, the contract is not treated as a binding contract that provides for fixed consideration. Accordingly, whether the transaction satisfies the continuity of interest requirement cannot be determined by reference to the value of the P stock on January 2 of year 1.

(ii) *Adjustment for anti-dilution clause*. The facts are the same as in paragraph (i) of this *Example 8* except that the contract contains a customary anti-dilution provision, and the T shareholders receive 80 P shares and $60 of cash in exchange for all of the outstanding stock of T. Under paragraph (e)(2)(iii)(E) of this section, the contract is treated as a binding contract that provides for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is generally determined by reference to the value of the P stock on January 2 of year 1. However, under paragraph (e)(2)(iii)(E) of this section, the value of the P stock on the pre-signing date must be adjusted to take the stock split into account. For continuity of interest purposes, the T stock is exchanged for $40 of P stock (($1/2) x 80) and $60 of cash. Therefore, the transaction satisfies the continuity of interest requirement.

Example 9. *Shareholder election*. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. On January 2 of year 1, the value of the P stock and the T stock is $1 per share. Pursuant to the contract, at the shareholders' election, each share of T's 100 shares will be exchanged for cash of $1, or alternatively, P stock. The contract provides that the determination of the number of shares of P stock to be exchanged for a share of T stock is made using the value of the P stock on the last business day before the first date there is a binding contract (that is, $1 per share). The contract further provides that, in the aggregate, 40 shares of P stock and $60 will be delivered, and contains a proration mechanism in the event that either item of consideration is oversubscribed. On the closing date, the value of the P stock is $.20 per share, and all target shareholders elect to receive cash. Pursuant to the proration provision, each target share is exchanged for $.60 of cash and $.08 of P stock. Pursuant to paragraph (e)(2)(iii)(A) of this section, the contract provides for fixed consideration because it provides for the number of shares of P stock and the amount of money to be exchanged for all the proprietary interests in the target corporation. Furthermore, pursuant to paragraph (e)(2)(iii)(B) of this section, the contract provides for fixed consideration because the number of shares of issuing corporation stock to be provided to the target corporation shareholders is determined using the pre-signing date value of P stock. Accordingly, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of year 1. Because, for continuity purposes, the T stock is exchanged for $40 of P stock and $60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 10. Contingent adjustment based on the value of the issuing corporation stock—continuity not preserved. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. On January 2 of year 1, the value of the P stock is $1 per share. Pursuant to the contract, if the value of the P stock does not decrease after January 2 of year 1, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive $.16 of additional P shares and $.24 for every $.01 decrease in the value of one share of P stock after January 2 of year 1. On June 1 of year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is $.40 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive 24 more P shares ((60 x $.16)/$.40) and $14.40 more cash (60 x $.24) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 64 P shares and $74.40 of cash. Because the contract provides that additional P shares and cash will be delivered to the T shareholders if the value of the stock of P decreases after January 2 of year 1, under paragraph (e)(2)(iii)(C)(*2*) of this section, the contract is not treated as providing for fixed consideration, and therefore whether the transaction satisfies the continuity of interest requirement cannot be determined by reference to the value of the P stock on January 2 of year 1. For continuity of interest purposes, the T stock is exchanged for $25.60 of P stock (64 x $.40) and $74.40 of cash and the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 11. Contingent adjustment to boot based on the value of the target corporation stock—continuity not preserved. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. On January 2 of year 1, T has 100 shares outstanding, and each T share is worth $1. On January 2 of year 1, each P share is worth $1. Pursuant to the contract, if the value of the T stock does not increase after January 3 of year 1, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive $1 of additional cash for every $.01 increase in the value of one share of T stock after January 3 of year 1. On June 1 of year 1, the value of the T stock is $1.40 per share and the value of the P stock is $.75 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive $40 more cash (40 x $1) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 40 P shares and $100 of cash. Because the contract provides the number of shares of P stock and the amount of money to be exchanged for all the proprietary interests in T, and the contingent adjustment to the cash consideration is not based on changes in the value of the P stock, P assets, or any surrogate thereof, after January 2 of year 1, there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of year 1. For continuity of interest purposes, the T stock is exchanged for $40 of P stock (40 x $1) and $100 of cash. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 12. Contingent adjustment to stock based on the value of the target corporation stock—continuity preserved. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. On that date T has 100 shares outstanding, and each T share is worth $1. On January 2 of year 1, each P share is worth $1. Pursuant to the contract, if the value of the T stock does not decrease after January 3 of year 1, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive $.40 less P stock and $.60 less cash for every $.01 decrease in the value of one share of T stock after January 3 of year 1. The contract also provides that the number of P shares by which the consideration will be reduced as a result of this adjustment will be determined based on the value of the P stock on January 2 of year 1. On June 1 of year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the T stock is $.70 per share and the value of the P stock is $.75 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive 12 fewer P shares ((30 x $.40)/$1) and $18 less cash (30 x $.60) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 28 P shares and $42 of cash. Because the contract provides for the number of shares of P stock and the amount of money to be exchanged for all of the proprietary interests in T, the contract does not provide for contingent adjustments to the consideration based on a change in value of the P stock, P assets, or any surrogate thereof, after January 2 of year 1, and the adjustment to the number of P shares the T shareholders receive is determined based on the value of the P shares on January 2 of year 1, there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of year 1. For continuity of interest purposes, the T stock is exchanged for $28 of P stock (28 x $1) and $42 of cash. Accordingly, the transaction satisfies the continuity of interest requirement.

* * * * *

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

(ii) *COI measurement date*. Paragraph (e)(2) of this section applies to transactions occurring pursuant to binding contracts entered into after December 19, 2011. For transactions entered into after March 19, 2010, and occurring pursuant to binding contracts entered into on or before December 19, 2011, the parties to the transaction may elect to apply the provisions of §1.368–1T as contained in 26 CFR, Part 1, §§1.301–1.400, revised as of April 1, 2009. However, the target corporation, the issuing corporation, the controlling corporation of the acquiring corporation if stock thereof is provided as consideration in the transaction, and any direct or indirect transferee of transferred basis property from any of the foregoing, may not elect to apply the provisions of §1.368–1T as contained in 26 CFR, Part 1, §§1.301–1.400, revised as of April 1, 2009, unless all such taxpayers elect to apply such provisions. This election requirement will be satisfied if none of the specified parties adopts inconsistent treatment. For transactions entered into on or before March 19, 2010, see §1.368–1T as contained in 26 CFR, Part 1, §§1.301–1.400, revised as of April 1, 2009.

§1.368–1T [Removed]

Par. 3. Section 1.368–1T is removed.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved December 6, 2011.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

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Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

(Also §§ 401(a)(11), 417; 26 CFR 1.401(a)–20.)

Application of survivor annuity requirements to deferred annuity contracts under a defined contribution plan. This ruling describes how the qualified joint and survivor annuity ("QJSA") and the qualified preretirement survivor annuity ("QPSA") rules, described in sections 401(a)(11) and 417 of the Code, apply when a deferred annuity contract is purchased under a profit-sharing plan.

Rev. Rul. 2012–3

ISSUE

How do the qualified joint and survivor annuity ("QJSA") and the qualified preretirement survivor annuity ("QPSA") rules, described in §§ 401(a)(11) and 417 of the Internal Revenue Code, apply when a deferred annuity contract is purchased under a profit-sharing plan in the situations described below?

FACTS

Situation 1

Company A sponsors Plan X, which is a profit-sharing plan qualified under § 401(a) with a qualified cash or deferred arrangement described in § 401(k). No portion of Plan X is an employee stock ownership plan. Plan X provides for both elective deferrals and matching contributions.

Plan X participants are permitted to direct the investment of their elective deferral and matching contribution accounts among any of the investment options available under the plan, including a deferred annuity contract that is issued by an insurance company. The plan separately accounts for all amounts by investment and contribution source.

No other annuity options are available under Plan X, and the plan is not a direct or indirect transferee of assets or benefits from another plan.

Amounts invested for a Plan X participant in a deferred annuity contract are applied at the time of investment to purchase a contract that provides for payments commencing by the first day of the first month that begins after the later of the date the participant retires or attains age 65 (subject to an exception that provides for an earlier commencement date in the case of any participant who is a 5% owner, as defined in § 416, who retires after age $70^{1}/_{2}$). The amount payable under the deferred annuity contract is fixed on the first day of the first period for which an amount is paid under the contract (the annuity starting date). The amount payable under the deferred annuity contract on the annuity starting date depends on the amount accumulated under the contract on that date and the actuarial assumptions, including interest rate and mortality assumptions, used to determine the annuity purchase rate on that date, subject to a minimum-purchase-rate guarantee set forth in the contract. Amounts invested in the deferred annuity contract can be transferred to other investments at any time before the annuity starting date.

In general, a deferred annuity contract under Plan X pays benefits in one of various life annuity forms that can be elected during the 180-day period ending on the annuity starting date, but the participant can instead elect, at any time before the annuity starting date, to have a single-sum payment. The form of payment, if no other form is elected, is a straight life annuity in the case of a participant who is not married on the annuity starting date and is a 50% joint and survivor annuity (with the surviving spouse as the joint annuitant) that is actuarially equivalent to the straight life annuity in the case of a participant who is married on that date. If the participant is married on the annuity starting date, the notarized consent of the spouse must be obtained if the participant elects a life annuity form other than a joint and survivor annuity with the surviving spouse as the joint annuitant and the survivor annuity not less than 50% or more than 100% of the joint annuity amount. Thus, for example, no spousal consent is required if a participant elects an annuity that satisfies the definition for a qualified optional survivor annuity ("QOSA") described in § 417(g).

Plan X provides that if a participant dies prior to the annuity starting date under the deferred annuity contract, the participant's surviving spouse (or, if there is no surviving spouse, the participant's designated beneficiary) will receive a death benefit equal to the nonforfeitable accrued benefit under the contract as of the date of death. The nonforfeitable accrued benefit under the deferred annuity contract is the contract's value calculated by taking into account 100% of the amounts attributable to both elective deferrals and matching contributions. In the case of a married participant, the death benefit is paid to the surviving spouse in the form of an annuity for the life of the surviving spouse (unless the surviving spouse elects a single-sum payment).

With respect to amounts not invested in a deferred annuity contract, Plan X provides that, upon the death of a participant, the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan on account of an outstanding participant loan) is payable in full to the participant's surviving spouse (or, if there is no surviving spouse or the surviving spouse gives notarized consent, to a designated beneficiary).

Participant P invests portions of his Plan X elective deferral and matching contribution accounts in the deferred annuity contract on various dates from age 45 to age 65, and retires at age 65. The annuity starting date for Participant P's benefit under the deferred annuity contract is the first day of the month after he retires.

Situation 2

The facts are the same as in Situation 1, except as follows.

A Plan X participant who invests amounts in a fixed deferred annuity contract may not subsequently transfer those amounts out of the contract and may not elect to take those amounts in the form of a single-sum payment. Thus, amounts invested in the deferred annuity contract will be paid in the form of a life annuity, without an option for the participant to accelerate payment of the amounts in the form of a single-sum payment.

The amount payable under the deferred annuity contract on a Plan X participant's annuity starting date in the form of a straight life annuity that is attributable to an amount invested in the contract is fixed on the date the investment is made. Thus, the amount payable under the fixed annuity contract depends on the amount invested in the contract on the date the investment is made and the actuarial assumptions, including interest rate and mortality assumptions, used to determine the annuity purchase rate on that date.

Situation 3

The facts are the same as in Situation 2, except as follows.

A Plan X participant who invests amounts in a deferred annuity contract can make an election to have no benefits payable under the contract with respect to amounts invested in the contract that are attributable to matching contributions in the event of death before the annuity starting date. If the participant makes this election, then the participant's spouse, if any, must give notarized consent to the election.

LAW

Section 401(a)(11) sets out two requirements regarding annuity benefit forms for certain retirement plans qualified under § 401(a). Except as provided under § 417, § 401(a)(11)(A)(i) requires that, in the case of a vested participant who does not die before his or her annuity starting date, the accrued benefit payable to the participant be provided in the form of a QJSA and § 401(a)(11)(A)(ii) requires that, in the case of a vested participant who dies before his or her annuity starting date and who has a surviving spouse, a QPSA be provided to the participant's surviving spouse.

Section 401(a)(11)(B)(i) and (ii) provides that the QJSA and QPSA requirements apply to any defined benefit plan and to any defined contribution plan that is subject to the funding standards of § 412. (Section 412(e)(2)(A) provides that the funding standards of § 412 do not apply to any profit-sharing or stock bonus plan.)

Section 401(a)(11)(B)(iii) provides that the QJSA and QPSA requirements also apply to a participant under any other defined contribution plan (*i.e.*, a profit-sharing or stock bonus plan) unless:

- The plan provides that the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan on account of an outstanding participant loan) is payable in full, on the death of the participant, to the participant's surviving spouse (or, if there is no surviving spouse or the surviving spouse consents, to a designated beneficiary) (§ 401(a)(11)(B)(iii)(I));
- The participant does not elect a payment of benefits in the form of a life annuity (§ 401(a)(11)(B)(iii)(II)); and
- With respect to the participant, the plan is not a direct or indirect transferee (in a transfer after 1984) of a plan that was subject to the QJSA and QPSA requirements with respect to the participant (§ 401(a)(11)(B)(iii)(III)).

Under § 401(a)(11)(B), if a defined contribution plan separately accounts for assets (and related income) that are transferred from a plan that is subject to the QJSA and QPSA requirements, then only those transferred assets (and related income) are subject to the QJSA and QPSA requirements on account of the transfer.

Section 417(a)(1) imposes a number of conditions in order for a plan to satisfy § 401(a)(11). These conditions include certain waiver, spousal consent, and written explanation rules relating to QJSAs and QPSAs, and also include requirements regarding the availability of a QOSA (as defined in § 417(g)). For example, § 417(a)(1)(A) generally imposes a condition that each participant must be able to elect at any time during an applicable election period (defined in § 417(a)(6)) to waive the QJSA form of benefit or the QPSA form of benefit (or both). However, under § 417(a)(5), this requirement that a participant be able to elect to waive the QJSA or QPSA form of benefit (as the case may be) does not apply if such benefit may not be waived (or another beneficiary selected) and the plan fully subsidizes the costs of such benefit.

Section 417(b) defines a QJSA as an annuity (1) for the life of the participant with a survivor annuity for the life of the spouse that is not less than 50% nor more than 100% of the amount of the annuity payable during their joint lives and (2) that is the actuarial equivalent of a single annuity for the life of the participant.

Section 417(c)(2) defines a QPSA, in the case of a defined contribution plan, as an annuity for the life of the spouse the actuarial equivalent of which is not less than 50% of the portion of the account balance of the participant (as of the date of death) to which the participant had a nonforfeitable right under § 411. For a defined contribution plan, the accrued benefit is defined in § 411(a)(7)(A)(ii) as the balance of the employee's account. In general, under § 417(f)(2)(A), the annuity starting date is the first day of the first period for which an amount is payable as an annuity or, in the case of a benefit not payable in the form of an annuity, the first day on which all events have occurred which entitle the participant to the benefit.

Section 401(a)(7) provides that, to be qualified under § 401(a), a retirement plan must satisfy the requirements of § 411. Section 411(a) requires that a plan provide that certain benefits are nonforfeitable upon attainment of normal retirement age or the completion of a specified number of years of service. However, § 411(a)(3)(A) permits certain forfeitures upon a participant's death (except in the case of a survivor annuity described in § 401(a)(11)). Pursuant to § 401(k)(2)(C), a qualified cash or deferred arrangement must provide that an employee's right to his or her accrued benefit derived from elective contributions is nonforfeitable. Section 1.401(k)–1(c)(2) of the Income Tax Regulations provides that the amount attributable to an employee's elective contributions may not be forfeited under § 411(a)(3)(A). In addition, § 1.401(a)–20, Q&A–20, provides that a contributory defined contribution plan with a § 411(a)(3)(A) forfeiture provision may not use more than a proportional percent of the account balance attributable to contributions that may not be forfeited at death (such as elective deferrals) to satisfy the QPSA benefit. Thus, for example, where a participant's date-of-death account balance comprises 60% attributable to elective deferrals and 40% attributable to matching contributions, the maximum portion of a QPSA that can consist of amounts attributable to elective deferrals is 60%.

Section 1.401(a)–11(b)(1) defines a life annuity to mean an "annuity that provides retirement payments and requires the survival of the participant or his spouse as one of the conditions for any payment or possible payment under the annuity." Thus, a joint and survivor annuity is a "life annuity" under this definition.

Section 1.401(a)–20 sets forth additional rules reflecting the amendments to § 401(a)(11) by the Retirement Equity Act of 1984, P.L. 98–397, and the enactment of § 417.

Under § 1.401(a)–20, Q&A–4, if a defined contribution plan separately accounts for an amount with respect to which a participant elects a life annuity, then only that separate account balance is subject to the QJSA and QPSA requirements on account of the participant's election of a life annuity.

Under § 1.401(a)–20, Q&A–37, if a plan fully subsidizes a QJSA or QPSA and does not allow a participant to waive the QJSA or QPSA, respectively, or to select a nonspouse beneficiary, then the plan is not required to provide the written explanation required by § 417(a)(3)(A) or (B). However, if the plan offers an election to waive the benefit or designate a beneficiary, it must satisfy the election, consent and notice requirements with respect to the subsidized benefit. Under § 1.401(a)–20, Q&A–38(b), a QPSA is fully subsidized in a defined contribution plan.

ANALYSIS

Since Plan X is neither a defined benefit plan nor a defined contribution plan that is subject to the funding standards of § 412, the plan satisfies the first two conditions in § 401(a)(11)(B) for the exception to the application of the QJSA and QPSA requirements. Under § 401(a)(11)(B)(iii), a plan must satisfy three additional conditions, set forth in § 401(a)(11)(B)(iii)(I), (II), and (III), to avoid being subject to the QJSA and QPSA requirements.

In Situation 1, Plan X satisfies the § 401(a)(11)(B)(iii)(I) condition because a participant's entire nonforfeitable accrued benefit, including amounts attributable to the investment in the deferred annuity contract, is payable in full, on the death of the participant prior to the annuity starting date, to the participant's surviving spouse (or, if there is no surviving spouse, the participant's designated beneficiary). Plan X satisfies the § 401(a)(11)(B)(iii)(III) condition because Plan X is not a direct or indirect transferee of a plan that was subject to the QJSA and QPSA requirements with respect to any participant.

Plan X also satisfies the § 401(a)(11)(B)(iii)(II) condition that the participant not elect a payment of benefits in the form of a life annuity. Although a life annuity is the default payment under the deferred annuity contract in Situation 1, Participant P can elect another form of payment prior to the annuity starting date under the contract, either by transferring amounts invested in the contract to another investment option (with respect to which other forms of distribution are available) or by electing a single-sum payment under the contract. Thus, in the absence of an affirmative election of a life annuity during the 180-day period ending on the annuity starting date, Participant P does not elect a life annuity under the deferred annuity contract until his annuity starting date with respect to the contract. Because Participant P does not elect a life annuity under the deferred annuity contract until his annuity starting date with respect to the contract, and the other conditions are satisfied for the exception under § 401(a)(11)(B)(iii), the plan is not subject to the QPSA requirements before the annuity starting date.

However, at the annuity starting date, if Participant P has not previously elected to receive another form of payment, Plan X becomes subject to the QJSA requirements with respect to the deferred annuity. Because Plan X separately accounts for the deferred annuity contract, the remainder of the plan is not subject to the QJSA and QPSA requirements.

In Situation 2, Plan X is generally subject to the QJSA and QPSA requirements of § 401(a)(11) with respect to Participant P's benefits under the deferred annuity contract beginning when Participant P first invests in the contract. The deferred annuity contract does not qualify for the exception under § 401(a)(11)(B)(iii) because, at the time Participant P invests amounts in the contract, he has elected a life annuity within the meaning of § 1.401(a)–11(b)(1).

The death benefit under the deferred annuity contract in Situation 2 provides the participant's surviving spouse a life annuity that is based on 100% of the amounts in the contract attributable to both elective deferrals and matching contributions. This satisfies the requirements for a QPSA under § 1.401(a)–20, Q&A–20, and, in particular, the requirement in § 1.401(a)–20, Q&A–20, that the plan provide a preretirement survivor annuity with a value which is not less than 50% of the nonforfeitable account balance as of the date of the participant's death.

Further, because the QPSA in Situation 2 satisfies the requirements in § 417(a)(5) that (1) the plan fully subsidize the costs of the QPSA (*i.e.*, no charge is imposed for the coverage) and (2) a participant may not waive the QPSA or select a nonspouse beneficiary, Plan X is not required to provide the written QPSA explanation otherwise required by § 417(a)(3) or obtain spousal consent with respect to a QPSA. However, since the QJSA does not satisfy the requirements of § 417(a)(5), Plan X must obtain notarized spousal consent for a participant to waive a QJSA and must provide the written QJSA explanation required by § 417(a)(3) before the annuity starting date.

The result would be the same if, in order to maximize the annuity payable during the participant's lifetime, death benefits under the deferred annuity contract were reduced to the minimum permissible. In such case, the QPSA would be based on 50% of the amounts invested in the contract that are attributable to elective deferrals and 50% of the amounts invested in the contract that are attributable to matching contributions. In addition, a death benefit based on the remaining 50% of the amounts invested in the contract that are attributable to elective deferrals would be payable to the participant's designated beneficiary.

In Situation 3, for the reasons described with respect to Situation 2, Plan X is generally subject to the QJSA and QPSA requirements of § 401(a)(11) with respect to Participant P's benefits under the deferred annuity contract beginning when Participant P first invests in the contract.

However, unlike in Situation 2, Plan X in Situation 3 is required to comply with the rules of § 417(a) with respect to the participant's waiver of the QPSA. This is because the § 417(a)(5)(A) exception from the requirements of § 417(a) imposes two conditions: (1) that the benefit not be waived and (2) that the benefit be fully subsidized. In Situation 3, unlike in Situation 2, the plan allows Participant P to waive the QPSA and thus must provide a written explanation and obtain notarized spousal consent to any waiver.

HOLDINGS

In Situation 1, Plan X qualifies for the exception in § 401(a)(11)(B)(iii), and thus is not subject to the QJSA and QPSA requirements of § 401(a)(11) with respect to Participant P's deferred annuity contract until Participant P's annuity starting date under the deferred annuity contract.

In Situation 2, Plan X is generally subject to the QJSA and QPSA requirements of § 401(a)(11) with respect to the deferred annuity contract beginning when Participant P first invests in the contract. The death benefit provided under the deferred annuity contract in Situation 2 satisfies the requirements to be a QPSA under § 1.401(a)–20, Q&A–20. Because the QPSA is fully subsidized in Situation 2 (*i.e.*, no charge is imposed for the coverage) and Plan X does not allow Participant P to waive the QPSA or to select a nonspouse beneficiary, the plan is not required to obtain spousal consent with respect to the QPSA.

In Situation 3, Plan X is generally subject to the QJSA and QPSA requirements of § 401(a)(11) with respect to the deferred annuity contract beginning when Participant P first invests in the contract. Because Plan X permits a participant to waive the QPSA, any such waiver must be accompanied by the spouse's notarized consent following a written explanation in accordance with the rules of § 417(a)(2) and (3).

In all three situations, because Plan X separately accounts for the deferred annuity contract, the remainder of the plan is not subject to the QJSA and QPSA requirements.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Larry Isaacs and Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. Mr. Isaacs and Mr. Kuehnle may be reached by e-mail at *RetirementPlanQuestions@irs.gov.*

(Also, §§ 411, 415; 26 CFR 1.401(a)(31), 1.411(a)–4, 1.411(a)–4T, 1.411(c)–1, 1.415(b)–1.)

Rollover from qualified defined contribution plan to qualified defined benefit plan to obtain additional annuity. This ruling describes whether a qualified defined benefit pension plan that accepts a direct rollover of an eligible rollover distribution from a qualified defined contribution plan maintained by the same employer satisfies sections 411 and 415 of the Code in a case in which the defined benefit plan provides an annuity resulting from the direct rollover.

Rev. Rul. 2012–4

ISSUES

1. Does a qualified defined benefit pension plan that accepts a direct rollover of an eligible rollover distribution from a qualified defined contribution plan maintained by the same employer satisfy §§ 411 and 415 of the Internal Revenue Code in a case in which the defined benefit plan provides an annuity resulting from the direct rollover that is determined by converting the amount directly rolled over into an actuarially equivalent immediate annuity using the applicable interest rate and the applicable mortality table under § 417(e)?
2. How does the result vary if the defined benefit plan applies different conversion factors for purposes of calculating the annuity resulting from the amount directly rolled over?

FACTS

Plan A is a profit-sharing plan sponsored by Employer X that is qualified under § 401(a). Plan A satisfies the requirements under § 401(a)(11)(B)(iii) to be exempted from the qualified joint and survivor annuity and qualified preretirement survivor annuity rules of § 401(a)(11). Plan A does not provide for after-tax employee contributions.

Plan B is a qualified defined benefit plan also sponsored by Employer X. Plan B permits benefits to commence at any time after separation from service and offers various optional forms of benefit. Plan B complies with all otherwise applicable rules under § 401(a), including the rules of §§ 401(a)(11), 411(a)(11), and 417 with respect to distributions and does not apply the rule of § 411(a)(11)(D) (*i.e.*, does not disregard rollover contributions for purposes of mandatory distributions of small amounts). As permitted under § 411(a)(3)(A), Plan B provides that, except to the extent of the qualified preretirement survivor annuity, the accrued benefit resulting from employer contributions is forfeited on the death of the participant. Plan B provides that a participant can elect to commence a distribution between 30 days and 180 days after the furnishing of the QJSA explanation that is required pursuant to § 417(a)(3). Plan B does not permit participants to elect a retroactive annuity starting date as provided under § 417(a)(7).

Plan B provides that it will accept a direct rollover from Plan A for any employee or former employee of Employer X who separates from service after age 55 with at least 10 years of service. Plan B will accept direct rollovers from Plan A with respect to an employee or former employee only if the individual is electing or has elected to commence receiving benefits from Plan B and the election specifies a single annuity starting date for all of the employee's or former employee's benefits under Plan B (including the additional benefit resulting from the direct rollover, which is determined as described below).

Neither Plan A nor Plan B is a governmental plan, a nonelecting church plan, or another plan to which § 411 does not apply under § 411(e)(1). Plan B does not contain a qualified cost-of-living arrangement within the meaning of § 415(k)(2).

Participant P's employment with Employer X terminates, and Participant P elects a distribution from Participant P's Plan A account balance that is made in the form of a direct rollover to Plan B. Participant P elects to receive payment of the benefit attributable to the rollover in the form of an annuity from Plan B. For the entire plan year that includes the date of the rollover, Plan B's adjusted funding target attainment percentage under § 436(j)(2) is at least 60 percent. Participant P is over age 55 and has at least 10 years of service with Employer X.

Plan B provides that if a participant in both Plan A and Plan B elects a direct rollover from Plan A to Plan B and elects to use that direct rollover amount to obtain an immediate straight life or other form of annuity from Plan B, then the amount of that annuity is determined as the actuarial equivalent of the amount rolled over from Plan A, where actuarial equivalence is determined using the applicable interest rate and mortality table under § 417(e). A package of election forms is used for the distribution from Plan A, the election of a direct rollover to Plan B, and the election of an immediate annuity from Plan B. The package provides for notarized spousal consent if the participant is married and elects a distribution from Plan B that is not a qualified joint and survivor annuity, and is accompanied by a disclosure that includes a statement that if Plan B terminates with insufficient funds to cover its benefit liabilities, the benefit resulting from the direct rollover will be subject to Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93–406, and a description of the maximum benefit limitation and other relevant Title IV limitations on guaranteed benefits.[1]

Plan B provides that if a participant in both Plan A and Plan B elects a direct rollover from Plan A to Plan B but the annuity starting date is after the time of the direct rollover (which could occur under Plan B if the annuity starting date elected by a participant is not more than 180 days after the date of the election notice provided under Plan B), then the amount of the annuity is determined by crediting the amount directly rolled over with interest at 120 percent of the Federal mid-term rate under § 1274 until the annuity starting date and then converting the resulting amount to an actuarially equivalent immediate annuity using the applicable interest rate and the applicable mortality table under § 417(e) that apply at that later annuity starting date.

If a participant under Plan B dies before the annuity starting date, a benefit equal to any amount directly rolled over by the participant to Plan B from Plan A (plus interest as described above) will be paid from Plan B to the participant's beneficiary, which is in addition to the death benefit under Plan B that would be paid if no amount had been directly rolled over to Plan B. However, if such a participant is married at the time of death and the participant did not waive (with notarized spousal consent) the qualified preretirement survivor annuity payable in accordance with §§ 401(a)(11) and 417, then the death benefit instead is a life annuity to the surviving spouse that is actuarially equivalent to the amount directly rolled over to Plan B from Plan A (plus interest as described above) determined using the applicable interest rate and mortality table under § 417(e), which is also in addition to the death benefit under Plan B that would be paid if no amount had been directly rolled over to Plan B.

LAW

Section 401(a)(7) requires that a qualified plan satisfy the requirements of § 411. Section 401(a)(16) requires that a qualified plan not provide for benefits or contributions that exceed the limitations of § 415.

Section 401(a)(31) requires that a participant in a qualified plan be permitted to elect to have a distribution made in the form of a direct rollover to another eligible retirement plan if the distribution qualifies as an eligible rollover distribution. Section 1.401(a)(31)–1, A–15, of the Income Tax Regulations provides that, for purposes of applying the plan qualification requirements of § 401(a), a direct rollover is a distribution and rollover of the eligible rollover distribution (rather than a transfer of assets and liabilities). Section 1.401(a)(31)–1, A–13, provides that a qualified plan is not required to accept rollovers or it can provide that it will accept rollovers under limited circumstances.

Section 411(a)(1) requires that the accrued benefit derived from an employee's contributions be nonforfeitable. Section 1.411(a)–4T provides that adjustments in benefits, such as adjustments in excess of reasonable actuarial assumptions, can result in an impermissible forfeiture of participants' rights. Section 1.411(a)–4(b)(1)(ii) provides that the benefit derived from employee contributions is not treated as forfeitable merely because, after commencement of annuity payments, the participant dies without receiving payments equal in amount to the nonforfeitable accrued benefit derived from mandatory contributions determined at the time of commencement.

Section 411(c)(2) prescribes rules for the determination of the accrued benefit derived from employee contributions. Under § 411(c)(2)(B), in the case of a qualified defined benefit plan, the accrued benefit derived from the contributions made by an employee is equal to the accumulated contributions expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under § 417(e)(3) (as of the determination date). Section 411(c)(2)(C) defines accumulated contributions as the mandatory contributions made by the employee, increased by interest. With respect to periods during plan years beginning on or after January 1, 1988, the interest is determined using the rate of 120 percent of

[1] The Pension Benefit Guaranty Corporation (PBGC) has informed the Service that Title IV generally applies to benefits resulting from a rollover, and is developing guidance on the Title IV treatment of such benefits, including guarantee limitations under section 4022 of ERISA and asset allocation under section 4044(a) of ERISA.

the Federal mid-term rate under § 1274 for the first month of each plan year for the period ending on the date the determination is being made, and using the interest rate under § 417(e)(3) for the period between the determination date and the normal retirement age. Under § 411(c)(2)(C) and § 1.411(c)–1(c)(4), mandatory contributions are defined as amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits (or additional benefits) under the plan attributable to employer contributions.

Section 411(c)(3) requires that, if the accrued benefit derived from employee contributions is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the accrued benefit derived from contributions made by the employee must be the actuarial equivalent of the amount determined under § 411(c)(2).

Section 415(a)(1)(A) provides that, in the case of a qualified defined benefit plan, the associated trust will not be a qualified trust if the plan provides benefits with respect to a participant in excess of the limitations under § 415(b). Section 415(b)(1) prescribes limitations that are based on the annual benefit determined under § 415(b)(2). Section 415(b)(2)(B) provides for adjustments, in accordance with regulations, to the benefit determined under the plan if employees contribute or make rollover contributions to the plan.

Section 1.415(b)–1(b)(1) prescribes rules for the determination of the annual benefit for purposes of § 415(b). Under § 1.415(b)–1(b)(1)(ii), the annual benefit does not include the annual benefit attributable to rollover contributions as described in § 401(a)(31). Section 1.415(b)–1(b)(2) provides rules for the determination of the annual benefit attributable to rollover contributions. Under § 1.415(b)–1(b)(2)(iii), the annual benefit attributable to rollover contributions is determined by applying the factors applicable to mandatory employee contributions as described in § 411(c)(2)(B) and (C) and the regulations thereunder.

Section 401(a)(29) requires that a qualified defined benefit plan (other than a multiemployer plan) satisfy the requirements of § 436. Section 436 sets forth a series of limitations on the accrual and payment of benefits under an underfunded plan. Section 436(b) places limitations on the payment of plant shutdown benefits and other unpredictable contingent event benefits; § 436(c) places limitations on plan amendments that increase liabilities for benefits; § 436(d) places limitations on the payment of accelerated benefit distributions; and § 436(e) places limitations on benefit accruals. These limitations are applied based on the plan's adjusted funding target attainment percentage (AFTAP) for the plan year, as certified by the plan's enrolled actuary.

ANALYSIS

Under § 1.401(a)(31)–1, A–15, an amount directly rolled over from Plan A to Plan B is treated as if it were distributed to Participant P from Plan A and then rolled over into Plan B. Accordingly, this amount is treated as contributed by Participant P to Plan B. Furthermore, the contribution is required as a condition of receiving additional benefits under Plan B attributable to employer contributions. For example, if the employee lives longer than the life expectancy under the mortality table used to calculate the annuity and there are no offsetting actuarial gains or the plan earns less than the interest rate used to calculate the annuity, the employer would be required to make contributions to provide the additional benefits. Thus, under § 1.411(c)–1(c)(4), the amounts directly rolled over are treated as mandatory contributions for purposes of § 411(c) and the accrued benefit derived from those amounts, determined under the rules of § 411(c), must be nonforfeitable.

The benefit resulting from the direct rollover that Plan B provides as an immediate annuity is determined as the actuarial equivalent of the amount rolled over from Plan A, where actuarial equivalence is determined using the applicable interest rate and mortality table under § 417(e). Furthermore, in the event of a delay between the rollover and the annuity starting date, interest on the rollover contribution is accumulated in accordance with the requirements of § 411(c)(2)(C)(iii). Thus, Plan B satisfies the requirements of § 411(c)(2) with respect to the rollover.

Prior to the annuity starting date under Plan B, the benefit resulting from the amount directly rolled over is not forfeitable, even if the participant were to die prior to the annuity starting date. If the participant were to die after the annuity starting date, the benefit resulting from the amount directly rolled over is not treated as being forfeited as a result of the cessation of the annuity, even if the participant dies prior to having received an amount equal to the amount rolled over to Plan B from Plan A plus interest as described above.

Accordingly, Plan B's provisions relating to the benefit resulting from the amount directly rolled over satisfy the requirement of § 411(a)(1) that the benefit derived from an employee's own contributions be nonforfeitable. In addition, the Plan B benefit resulting from the amount directly rolled over is excluded from Participant P's annual benefit for purposes of § 415(b). This is because, under § 1.415(b)–1(b), the annual benefit for purposes of § 415(b) excludes the benefit attributable to rollover contributions, determined using the rules of § 411(c)(2)(B) and (C), and the Plan B benefit resulting from the amount directly rolled over is determined using the rules of § 411(c)(2)(B) and (C).

However, if Plan B were to use a less favorable actuarial basis (such as an interest rate that is lower than the applicable interest rate under § 417(e)(3)(C) or a mortality table with longer life expectancies than the applicable mortality table under § 417(e)(3)(B)) to determine the amount of an annuity resulting from the amount rolled over, Plan B would not satisfy the requirement under § 411(a)(1) that the benefit derived from an employee's own contributions be nonforfeitable.

By contrast, if Plan B were to use a more favorable actuarial basis (such as a higher interest rate than the § 417(e)(3)(C) applicable interest rate or a mortality table with shorter life expectancies than the applicable § 417(e)(3)(B) mortality table) for purposes of calculating the annuity resulting from the rollover amount, or otherwise provided for a larger annuity than the annuity derived from employee contributions as determined under § 411(c), then the portion of the Plan B benefit resulting from the amount directly rolled over that exceeds the benefit derived from that rolled over amount under the rules of § 411(c)(2)(B) is not treated as the benefit derived from the employee's own contributions and there are other considerations which must be taken into account. For example, the liability for additional benefits under Plan B will likely be greater than the assets transferred to the Plan (which means that the employer will become responsible for additional funding costs). Similarly, the excess portion would be included in the annual benefit for purposes of § 415(b). In addition, any benefit that exceeds the actuarial equivalent of the amount directly rolled over (determined using reasonable actuarial assumptions) would not be treated as attributable to the rollover within the meaning of § 1.401(a)(4)–11(b)(1), and, accordingly, would be taken into account in applying the nondiscriminatory amount requirement of § 1.401(a)(4)–1(b)(2).

The election procedures under Plans A and B that are described in the facts of this revenue ruling satisfy the requirements of §§ 401(a)(11), 411(a)(11), and 417.

If Plan B's certified or presumed AFTAP were to drop below 60%, Plan B would not be permitted to receive direct rollover contributions from Plan A because such rollover contributions would give rise to additional benefit accruals that are not permitted under § 436(e).

The analysis in this revenue ruling would be the same if Plan B allowed the annuity resulting from the amount directly rolled over to have an annuity starting date that differs from the annuity starting date for the remainder of the Plan B benefits.

HOLDINGS

1. Under the facts presented, a qualified defined benefit plan that accepts a direct rollover of an employee's or former employee's benefit from a qualified defined contribution plan maintained by the same employer does not violate § 411 or 415 if the defined benefit plan provides an annuity resulting from the direct rollover that is determined by converting the amount directly rolled over into an actuarially equivalent immediate annuity using the applicable interest rate and applicable mortality table under § 417(e).
2. If a defined benefit plan were to provide an annuity resulting from the rollover amount that is determined using a less favorable actuarial basis than required under the rules of § 411(c) (so that the annuity is smaller than required under the rules of § 411(c)), then the plan would not satisfy the requirements of § 411(a)(1).
3. If a defined benefit plan were to provide an annuity resulting from the rollover amount that is determined using a more favorable actuarial basis than required under the rules of § 411(c) (so that the annuity is larger than required under the rules of § 411(c)), then the portion of the benefit resulting from the amount directly rolled over that exceeds the benefit derived from that rolled over amount under the rules of § 411(c)(2)(B) would be subject to the non-forfeiture rules applicable to benefits derived from employer contributions and would be included in the annual benefit for purposes of § 415(b).

PROSPECTIVE APPLICATION

Pursuant to the authority provided by § 7805(b)(8), the holdings of this revenue ruling do not apply with respect to rollovers made before January 1, 2013. However, plan sponsors are permitted to rely on the holdings of this ruling with respect to rollovers made prior to that date.

DRAFTING INFORMATION

The principal author of this revenue ruling is Carolyn E. Zimmerman of the Employee Plans, Tax Exempt and Government Entities Division. Ms. Zimmerman may be reached by e-mail at *RetirementPlanQuestions@irs.gov*.

Section 6011.—General Requirements of Return, Statement, or List

26 CFR 31.6011(a)–1: Returns under federal insurance contributions act.

T.D. 9566

Employer's Annual Federal Tax Return and Modifications to the Deposit Rules

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the Employers' Annual Federal Tax Program (the Form 944 Program) and the requirements for depositing social security, Medicare, and withheld Federal income taxes (collectively "employment taxes"). These final regulations allow certain employers to file a Form 944, "*Employer's ANNUAL Federal Tax Return*," rather than Forms 941, "*Employer's QUARTERLY Federal Tax Return*." Additionally, these final regulations provide guidance related to the lookback periods and deposit requirements for employers required to file Forms 941 and Form 944. These final regulations affect taxpayers that file Forms 941, Form 944, and any related Spanish-language returns or returns for U.S. possessions.

DATES: *Effective Date:* These regulations are effective on December 14, 2011.

Applicability Date: For dates of applicability, see §§31.6011(a)–1(g), 31.6011(a)–4(d), and 31.6302–1(n).

FOR FURTHER INFORMATION CONTACT: Jennifer Records, (202) 622–4910 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

These final regulations amend the Regulations on Employment Taxes and Collection of Income Tax at Source (26 CFR part 31) under section 6011 relating to the employment tax return filing requirements and section 6302 relating to the employment tax deposit requirements. These final regulations are part of the IRS' continued effort to reduce taxpayer burden by permitting certain employers to file one employment tax return annually instead of four quarterly employment tax returns.

The Treasury Department and the IRS are considering changes to the annual filing program in light of the program's performance as measured against the program's original goals, administrative and operational considerations, and overall program effectiveness. Any changes to the program will be set forth in future guidance.

On January 3, 2006, temporary regulations (T.D. 9239, 2006–1 C.B. 401) relating to Form 944 (the 2006 temporary regulations) were published in the **Federal Register** (71 FR 11). A notice of proposed rulemaking (REG–148568–04, 2006–1 C.B. 417) cross-referencing the 2006 temporary regulations was published in the **Federal Register** on the same day (71 FR 46) (the 2006 proposed regulations). A correction to the 2006 temporary regulations was published in the **Federal Register** on March 17, 2006 (71 FR 13766). On December 29, 2008, temporary regulations (T.D. 9440, 2009–5 I.R.B. 409), which revised the 2006 temporary regulations, relating to Form 944 (the 2008 temporary regulations) were published in the **Federal Register** (73 FR 79354). A notice of proposed rulemaking (REG–148568–04) cross-referencing the 2008 temporary regulations was published in the **Federal Register** on the same day (73 FR 79423) (the 2008 proposed regulations). No requests for a public hearing were received; therefore, no public hearing was held. As noted in the 2008 temporary regulations, comments were received responding to the 2006 notice of proposed rulemaking. Those comments requested that use of Form 944 be changed from mandatory to voluntary and that the amount of the employment tax liability used to determine whether employers are eligible to file Form 944 (the "eligibility threshold") be increased. The Treasury Department and the IRS agreed to make Form 944 voluntary and to continue to consider whether to increase the eligibility threshold. No comments responding to the 2008 notice of proposed rulemaking were received. This Treasury decision adopts the rules of the 2008 proposed regulations with minor clarifying changes and removes the temporary regulations. That is, participation in the Form 944 Program will remain voluntary and the eligibility threshold for participation will remain at $1,000.

Explanation of Revisions

Although this Treasury decision adopts the rules of the proposed regulations with no substantive change, some of the language included in the proposed regulations and the existing final regulations is clarified and updated to reflect current law and practice. The revisions are discussed in this preamble.

Employers that request to participate in the Form 944 Program must receive written notice to file Form 944 before they are permitted to file the form. Once employers receive this notice, they must file Form 944 for each year and cannot file Forms 941 until they are notified that their filing requirement has changed to Forms 941 because (1) they contacted the IRS to request that their filing requirement be changed to Forms 941, or (2) they no longer qualify for the Form 944 Program. The IRS issued guidance published in the Internal Revenue Bulletin (Rev. Proc. 2009–13, 2009–3 I.R.B. 323, and Rev. Proc. 2009–51, 2009–45 I.R.B. 625) that provides procedures for employers to follow to request to file Form 944 instead of Forms 941 ("opt in"). Additionally, Rev. Proc. 2009–13 and Rev. Proc. 2009–51 provide procedures for employers to follow to request to file Forms 941 instead of Form 944 when the IRS previously notified them they should file Form 944 ("opt out"). Under Rev. Proc. 2009–13, for tax year 2009, employers who were notified they should file Form 944 could only opt out if they anticipated that their employment tax liability would exceed the $1,000 threshold or if they wanted to e-file Forms 941 quarterly instead. Beginning in 2010, employers were able to opt out of filing Form 944 for any reason if they followed the procedures set forth in Rev. Proc. 2009–51 or its successor. These final regulations clarify that employers should follow the procedures contained in Rev. Proc 2009–51 or its successor to opt in or to opt out of the Form 944 Program.

The revisions contained in these final regulations also impact employers that file Spanish-language returns or returns for U.S. possessions. For tax year 2012 and later, Form 944–SS, *Employer's ANNUAL Federal Tax Return (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands)* and Form 944–PR, *Planilla para la Declaración Federal ANUAL del Patrono*, will be eliminated due to the low volume of employers filing these forms. Employers who would otherwise file a Form 944–SS or Form 944–PR will file a Form 944. The Treasury Department and the IRS plan to retain Form 944(SP), *Declaración Federal ANUAL de Impuestos del Patrono o Empleador*, which is the Spanish equivalent of Form 944. Employers in the United States in the Form 944 Program may file Form 944(SP) as an alternative to filing Form 944. Additionally, employers in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the U.S. Virgin Islands, and Puerto Rico may file a Form 944(SP) as an alternative to filing Form 944, for tax year 2012 and later. These final regulations remove references to the eliminated forms and update the language included in the proposed regulations and the existing final regulations to provide guidance to former Form 944–SS and Form 944–PR filers who are required to file Form 944 instead.

Employers in American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands who are required to file Form 944 for tax year 2012 and later can request to file Forms 941–SS instead of Form 944. Employers in Puerto Rico who are required to file Form 944 for tax year 2012 and later can request to file Forms 941–PR instead of Form 944. Employers required to file Form 944 should follow the procedures contained in Rev. Proc. 2009–51 or its successor to request to file Form 941–SS or Form 941–PR. See §601.601(d)(2)(ii)(*b*).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It 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. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. Chapter 6). The regulations under sections 6011 and 6302 affect only a small number of taxpayers that file employment tax returns, and participation in the Form 944 Program is voluntary. Therefore, the Treasury Department and the IRS have determined that the regulations will not affect a substantial number of small entities. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small entities. No comments from the Small Business Administration were received.

Drafting Information

The principal authors of these regulations are Blaise Dusenberry and Jennifer Records of the Office of the Associate Chief Counsel (Procedure and Administration).

* * * * *

Adoption Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 is amended by removing the entry for §31.6302–1T to read in part as follows:

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

Par. 2. Section 31.6011(a)–1 is amended by revising paragraphs (a)(1), (a)(4), (a)(5) and (g) to read as follows:

§31.6011(a)–1 Returns under Federal Insurance Contributions Act.

(a) *Requirement*—(1) *In general.* Except as otherwise provided in paragraphs (a)(3) and (a)(5) of this section and in §31.6011(a)–5 every employer is required to make a return for the first calendar quarter in which the employer pays wages, other than wages for agricultural labor, subject to the tax imposed by the Federal Insurance Contributions Act, and is required to make a return for each subsequent calendar quarter (whether or not wages are paid therein) until the employer has filed a final return in accordance with §31.6011(a)–6. Except as otherwise provided in §31.6011(a)–8 and in paragraphs (a)(3), (a)(4), and (a)(5) of this section, Form 941, "*Employer's QUARTERLY Federal Tax Return*," is the form prescribed for making the return required by this paragraph (a)(1). Such return shall not include wages for agricultural labor required to be reported on any return prescribed by paragraph (a)(2) of this section. The return shall include wages received by an employee in the form of tips only to the extent of the tips reported by the employee to the employer in a written statement furnished to the employer pursuant to section 6053(a).

* * * * *

(4) *Employers in Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands.* Except as otherwise provided in paragraph (a)(5), Form 941–PR, "*Planilla para la Declaracion Federal TRIMESTRAL del Patrono,*" is the form prescribed for use in making the return required under paragraph (a)(1) of this section in the case of every employer whose principal place of business is in Puerto Rico, or if the employer has employees who are subject to income tax withholding for Puerto Rico. Except as otherwise provided in paragraph (a)(5), Form 941–SS, "*Employer's QUARTERLY Federal Tax Return (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands),*" is the form prescribed for use in making the return required under paragraph (a)(1) of this section in the case of every employer whose principal place of business is in the U.S. Virgin Islands, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands, or if the employer has employees who are subject to income tax withholding for these U.S. possessions. Form 941 (or Form 944, as described under paragraph (a)(5) of this section, if the IRS notified the employer that Form 944 must be filed in lieu of Form 941) is the form prescribed for making the return in the case of every employer who is required pursuant to §31.6011(a)–4 to make a return of income tax withheld from wages.

(5) *Employers in the Employers' Annual Federal Tax Program (Form 944)*—(i) *In general.* Employers notified of their qualification for the Employers' Annual Federal Tax Program (Form 944) are required to file Form 944, "*Employer's ANNUAL Federal Tax Return*," instead of Form 941 (or Form 941–SS or Form 941–PR under paragraph (a)(4) of this section) to make a return as required by paragraph (a)(1) of this section. Upon proper request by the employer, the IRS will notify employers in writing of their qualification for the Employers' Annual Federal Tax Program (Form 944). The IRS will notify employers when they no longer qualify for the Employers' Annual Federal Tax Program (Form 944) and must file Forms 941 instead. Qualified employers are those with an estimated annual employment tax liability (that is, social security, Medicare, and withheld Federal income taxes) of $1,000 or less for the entire calendar year, except employers required under—

(A) Paragraph (a)(2) of this section to make a return on Form 943, "*Employer's Annual Federal Tax Return For Agricultural Employees*"; or

(B) Paragraph (a)(3) of this section to make a return on Schedule H (Form 1040), "*Household Employment Taxes*."

(ii) *Requests to opt in or opt out of the Employers' Annual Federal Tax Program (Form 944).* The IRS has established procedures in Revenue Procedure 2009–51 published in the Internal Revenue Bulletin for employers to follow to request to participate in the Employers' Annual Federal Tax Program (Form 944) (to opt in) and to request to be removed from the Employers' Annual Federal Tax Program (Form 944) after becoming a participant in order to file Forms 941 instead (to opt out). The IRS will notify employers that their filing requirements have changed to Form 944 or Forms 941. Employers must follow the procedures in Revenue Procedure 2009–51 or its successor to request to opt in or opt out of the Employers' Annual Federal Tax Program (Form 944).

* * * * *

(g) *Effective/applicability dates*. Paragraphs (a)(1) and (a)(5)(i) of this section apply to taxable years beginning on or after December 30, 2008. Paragraph (a)(4) of this section applies to taxable years beginning on or after January 1, 2012. Paragraph (a)(5)(ii) of this section applies to taxable years beginning on or after January 1, 2010. The rules of paragraph (a)(1) of this section that apply to taxable years beginning before December 30, 2008, are contained in §31.6011(a)–1 as in effect prior to December 30, 2008. The rules of paragraph (a)(4) of this section that apply to taxable years beginning before January 1, 2012, are contained in §31.6011(a)–1 as in effect prior to January 1, 2012. The rules of paragraph (a)(5)(ii) of this section that apply to taxable years beginning before January 1, 2010, but on or after December 30, 2008, are contained in §31.6011(a)–1T as in effect on or after December 30, 2008. The rules of paragraph (a)(5) of this section that apply to taxable years beginning before December 30, 2008, are contained in §31.6011(a)–1T as in effect prior to December 30, 2008.

§31.6011(a)–1T [Removed].

Par. 3. Section 31.6011(a)–1T is removed.

Par. 4. Section 31.6011(a)–4 is amended by revising paragraphs (a)(1), (a)(4) and (d) to read as follows:

§31.6011(a)–4 Returns of income tax withheld.

(a) *Withheld from wages*—(1) *In general*. Except as otherwise provided in paragraphs (a)(2), (a)(3), (a)(4), and (b) of this section, and in §31.6011(a)–5, every person required to make a return of income tax withheld from wages pursuant to section 3402 shall make a return for the first calendar quarter in which the person is required to deduct and withhold such tax and for each subsequent calendar quarter, whether or not wages are paid therein, until the person has filed a final return in accordance with §31.6011(a)–6. Except as otherwise provided in paragraphs (a)(2), (a)(3), (a)(4), and (b) of this section, and in §31.6011(a)–8, Form 941, "*Employer's QUARTERLY Federal Tax Return*," is the form prescribed for making the return required under this paragraph (a)(1).

* * * * *

(4) *Employers in the Employers' Annual Federal Tax Program (Form 944)*—(i) *In general*. Employers notified of their qualification for the Employers' Annual Federal Tax Program (Form 944) are required to file Form 944, "*Employer's ANNUAL Federal Tax Return*," instead of Form 941 to make a return of income tax withheld from wages pursuant to section 3402. Upon proper request by the employer, the IRS will notify employers in writing of their qualification for the Employers' Annual Federal Tax Program (Form 944). The IRS will notify employers when they no longer qualify for the Employers' Annual Federal Tax Program (Form 944) and must file Forms 941 instead. Qualified employers are those with an estimated annual employment tax liability (that is, social security, Medicare, and withheld federal income taxes) of $1,000 or less for the entire calendar year, except employers required under—

(A) Paragraph (a)(3) of this section to make a return on Form 943, "*Employer's Annual Federal Tax Return For Agricultural Employees*"; or

(B) Paragraph (a)(2) of this section to make a return on Schedule H (Form 1040), "*Household Employment Taxes*."

(ii) *Request to opt in or opt out of the Employers' Annual Federal Tax Program (Form 944)*. The IRS established procedures in Revenue Procedure 2009–51 published in the Internal Revenue Bulletin for employers to follow to request to participate in the Employers' Annual Federal Tax Program (Form 944) (to opt in) and to request to be removed from the Employers' Annual Federal Tax Program (Form 944) after becoming a participant in order to file Forms 941 instead (to opt out). The IRS will notify employers that their filing requirements have changed to Form 944 or Forms 941. Employers must follow the procedures in Revenue Procedure 2009–51 or its successor to opt in or opt out of the Employers' Annual Federal Tax Program (Form 944).

* * * * *

(d) *Effective/applicability dates*. Paragraphs (a)(1) and (a)(4)(i) of this section apply to taxable years beginning on or after December 30, 2008. Paragraph (a)(4)(ii) of this section applies to taxable years beginning on or after January 1, 2010. The rules of paragraph (a)(1) of this section that apply to taxable years beginning before December 30, 2008, are contained in §31.6011(a)–4 as in effect prior to December 30, 2008. The rules of paragraph (a)(4)(ii) of this section that apply to taxable years beginning before January 1, 2010, but on or after December 30, 2008, are contained in §31.6011(a)–4T as in effect on or after December 30, 2008. The rules of paragraph (a)(4) of this section that apply to taxable years beginning before December 30, 2008, are contained in §31.6011(a)–4T as in effect prior to December 30, 2008. Paragraph (b)(6) of this section (relating to certain payments made by government entities subject to withholding under section 3402(t)) applies to payments made by government entities under section 3402(t) after December 31, 2012.

§31.6011(a)–4T [Removed].

Par. 5. Section 31.6011(a)–4T is removed.

Par. 6. Section 31.6071(a)–1 is amended by revising paragraph (a)(1) to read as follows:

§31.6071(a)–1 Time for filing returns and other documents.

(a) *Federal Insurance Contributions Act and income tax withheld from wages and from nonpayroll payments*—(1) *Quarterly or annual returns.* Except as provided in paragraph (a)(4) of this section, each return required to be made under §31.6011(a)–1, in respect of the taxes imposed by the Federal Insurance Contributions Act (26 U.S.C. 3101–3128), or required to be made under §31.6011(a)–4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. A return may be filed on or before the 10th day of the second calendar month following such period if timely deposits under section 6302(c) of the Code and the regulations have been made in full payment of such taxes due for the period.

* * * * *

Par. 7. Section 31.6302–0 is amended as follows:

1. Revising the introductory text.

2. Revising the section heading for §31.6302–1.

3. Adding entries for paragraphs (b)(4)(i), (b)(4)(ii), (c)(5), (c)(6), (f)(4)(ii) and (f)(4)(iii) for §31.6302–1.

4. Revising the entries for paragraphs (d), (f)(4)(i), (f)(5), (g)(1) and (n) for §31.6302–1.

5. Removing the heading for §31.6302–1T and the entries for paragraphs (a) though (n).

The revisions and additions to read as follows:

§31.6302–0 Table of contents.

This section lists the table of contents for §§31.6302–1 through 31.6302–4.

§31.6302–1 Deposit rules for taxes under the Federal Insurance Contributions Act (FICA) and withheld income taxes.

* * * * *

(b) * * *

(4) * * *

(i) In general.

(ii) Adjustments and claims for refund.

(c) * * *

(5) Exception to the monthly and semi-weekly deposit rules for employers in the Employers' Annual Federal Tax Program (Form 944).

(6) Extension of time to deposit for employers in the Employers' Annual Federal Tax Program (Form 944) during the preceding year.

* * * * *

(d) Examples.

* * * * *

(f) * * *

(4) * * *

(i) *De minimis* deposit rules for quarterly and annual return periods beginning on or after January 1, 2001.

(ii) *De minimis* deposit rule for quarterly return periods beginning on or after January 1, 2010.

(iii) *De minimis* deposit rule for employers who file Form 944.

(5) Examples.

(g) * * *

(1) In general.

* * * * *

(n) Effective/applicability dates.

* * * * *

§31.6302–0T [Removed].

Par. 8. Section 31.6302–0T is removed.

Par. 9. Section 31.6302–1 is amended by revising paragraphs (b)(4), (c)(5), (c)(6), (d) *Example 6*, (e)(2), (f)(4), (f)(5) *Example 3*, (g)(1) and (n) to read as follows:

§31.6302–1 Deposit rules for taxes under the Federal Insurance Contributions Act (FICA) and withheld income taxes.

* * * * *

(b) * * *

(4) *Lookback period*—(i) *In general*. For employers who file Form 941, "*Employer's QUARTERLY Federal Tax Return*," (or any related Spanish-language returns or returns for U.S. possessions) the lookback period for each calendar year is the twelve month period ended the preceding June 30. For example, the lookback period for calendar year 2006 is the period July 1, 2004, to June 30, 2005. The lookback period for employers who file Form 944, "*Employer's ANNUAL Federal Tax Return*," or filed Form 944 (or any related Spanish-language returns or returns for U.S. possessions) for either of the two previous calendar years, is the second calendar year preceding the current calendar year. For example, the lookback period for calendar year 2006 is calendar year 2004. In determining status as either a monthly or semi-weekly depositor, an employer should determine the aggregate amount of employment tax liabilities reported on its return(s) (Forms 941 or Form 944) for the lookback period. The amount of employment tax liabilities reported for the lookback period is the amount the employer reported on either Forms 941 or Form 944 even if the employer is required to file the other form for the current calendar year. New employers shall be treated as having employment tax liabilities of zero for any part of the lookback period before the date the employer started or acquired its business.

(ii) *Adjustments and claims for refund*. The employment tax liability reported on the original return for the return period is the amount taken into account in determining whether the aggregate amount of employment taxes reported for the lookback period exceeds $50,000. Any amounts reported on adjusted returns or claims for refund pursuant to sections 6205, 6402, 6413, and 6414 filed after the due date of the original return are not taken into account when determining the aggregate amount of employment taxes reported for the lookback period. Prior period adjustments reported on Forms 941 or Form 944 for 2008 and earlier years are taken into account in determining the employment tax liability for the return period in which the adjustments are reported.

(c) * * *

(5) *Exception to the monthly and semi-weekly deposit rules for employers in the Employers' Annual Federal Tax Program (Form 944)*. Generally, an employer who files Form 944 for a taxable year may remit its accumulated employment taxes with its timely filed return for that taxable year and is not required to deposit under either the monthly or semi-weekly rules set forth in paragraphs (c)(1) and (c)(2) of this section during that taxable year. An employer who files Form 944 whose actual employment tax liability exceeds the eligibility threshold, as set forth in §§31.6011(a)–1(a)(5) and 31.6011(a)–4(a)(4), will not qualify for this exception and should follow the deposit rules set forth in this section.

(6) *Extension of time to deposit for employers in the Employers' Annual Federal Tax Program (Form 944) during the preceding year*. An employer who filed Form 944 for the preceding year but will file Forms 941 instead for the current year will be deemed to have timely deposited its current year's January deposit obligation(s) under paragraphs (c)(1) through (c)(4) of this section if the employer deposits the amount of such deposit obligation(s) by March 15 of that year.

* * * * *

(d) * * *

Example 6. Extension of time to deposit for employers who filed Form 944 for the preceding year satisfied. F (a monthly depositor) was notified to file Form 944 to report its employment tax liabilities for the 2006 calendar year. F filed Form 944 on January 31, 2007, reporting a total employment tax liability for 2006 of $3,000. Because F's annual employment tax liability for the 2006 taxable year exceeded $1,000 (the applicable eligibility threshold for that taxable year), the IRS notified F to file Forms 941 for calendar year 2007 and thereafter. Based on F's liability during the lookback period (calendar year 2005, pursuant to paragraph (b)(4)(i) of this section), F is a monthly depositor for 2007. F accumulates $1,000 in employment taxes during January 2007. Because F is a monthly depositor, F's January deposit obligation is due February 15, 2007.

F does not deposit these accumulated employment taxes on February 15, 2007. F accumulates $1,500 in employment taxes during February 2007. F's February deposit is due March 15, 2007. F deposits the $2,500 of employment taxes accumulated during January and February on March 15, 2007. Pursuant to paragraph (c)(6) of this section, F will be deemed to have timely deposited the employment taxes due for January 2007, and, thus, the IRS will not impose a failure-to-deposit penalty under section 6656 for that month.

(e) * * *

(2) The term *employment taxes* does not include taxes with respect to wages for domestic service in a private home of the employer, unless the employer is otherwise required to file a Form 941 or Form 944 under §31.6011(a)–4 or §31.6011(a)–5. In the case of employers paying advance earned income credit amounts for periods ending before January 1, 2011, the amount of taxes required to be deposited shall be reduced by advance amounts paid to employees. Also, see §31.6302–3 concerning a taxpayer's option with respect to payments made before January 1, 1994, to treat backup withholding amounts under section 3406 separately.

(f) * * *

(4) *De minimis rule*—(i) *De minimis deposit rules for quarterly and annual return periods beginning on or after January 1, 2001*. If the total amount of accumulated employment taxes for the return period is *de minimis* and the amount is fully deposited or remitted with a timely filed return for the return period, the amount deposited or remitted will be deemed to have been timely deposited. The total amount of accumulated employment taxes is *de minimis* if it is less than $2,500 for the return period or if it is *de minimis* pursuant to paragraph (f)(4)(ii) of this section.

(ii) *De minimis deposit rule for quarterly return periods beginning on or after January 1, 2010*. For purposes of paragraph (f)(4)(i) of this section, if the total amount of accumulated employment taxes for the immediately preceding quarter was less than $2,500, unless §31.6302–1(c)(3) applies to require a deposit at the close of the next day, then the employer will be deemed to have timely deposited the employer's employment taxes for the current quarter if the employer complies with the time and method payment requirements contained in paragraph (f)(4)(i) of this section.

(iii) *De minimis deposit rule for employers who file Form 944*. An employer who files Form 944 whose employment tax liability for the year equals or exceeds $2,500 but whose employment tax liability for a quarter of the year is *de minimis* pursuant to paragraph (f)(4)(i) of this section will be deemed to have timely deposited the employment taxes due for that quarter if the employer fully deposits the employment taxes accumulated during the quarter by the last day of the month following the close of that quarter. Employment taxes accumulated during the fourth quarter can be either deposited by January 31 or remitted with a timely filed return for the return period.

(5) * * *

Example 3. De minimis deposit rule for employers who file Form 944 satisfied. K (a monthly depositor) was notified to file Form 944 to report its employment tax liabilities for the 2006 calendar year. In the first quarter of 2006, K accumulates employment taxes in the amount of $1,000. On April 28, 2006, K deposits the $1,000 of employment taxes accumulated in the first quarter. K accumulates another $1,000 of employment taxes during the second quarter of 2006. On July 31, 2006, K deposits the $1,000 of employment taxes accumulated in the second quarter. K's business grows and accumulates $1,500 in employment taxes during the third quarter of 2006. On October 31, 2006, K deposits the $1,500 of employment taxes accumulated in the third quarter. K accumulates another $2,000 in employment taxes during the fourth quarter. K files Form 944 on January 31, 2007, reporting a total employment tax liability for 2006 of $5,500 and submits a check for the remaining $2,000 of employment taxes with the return. K will be deemed to have timely deposited the employment taxes due for all of 2006 because K complied with the *de minimis* deposit rule provided in paragraph (f)(4)(iii) of this section. Therefore, the IRS will not impose a failure-to-deposit penalty under section 6656 for any month of the year. Under this *de minimis* deposit rule, because K was required to file Form 944 for calendar year 2006, if K's employment tax liability for a quarter is *de minimis*, then K may deposit that quarter's liability by the last day of the month following the close of the quarter. This *de minimis* rule allows K to have the benefit of the same quarterly *de minimis* amount K would have received if K filed Form 941 each quarter instead of Form 944 annually. Thus, because K's employment tax liability for each quarter was *de minimis*, K could deposit quarterly.

(g) *Agricultural employers—special rules*—(1) *In general*. An agricultural employer reports wages paid to farm workers annually on Form 943 (*Employer's Annual Tax Return for Agricultural Employees*) and reports wages paid to nonfarm workers quarterly on Form 941 or annually on Form 944. Accordingly, an agricultural employer must treat employment taxes reportable on Form 943 ("Form 943 taxes") separately from employment taxes reportable on Form 941 or Form 944 ("Form 941 or Form 944 taxes"). Form 943 taxes and Form 941 or Form 944 taxes are not combined for purposes of determining whether a deposit of either is due, whether the One-Day rule of paragraph (c)(3) of this section applies, or whether any safe harbor is applicable. In addition, Form 943 taxes and Form 941 or Form 944 taxes must be deposited separately. (See paragraph (b) of this section for rules for determining an agricultural employer's deposit status for Form 941 taxes). Whether an agricultural employer is a monthly or semi-weekly depositor of Form 943 taxes is determined according to the rules of this paragraph (g).

* * * * *

(n) *Effective/applicability dates*. Except for the deposit of employment taxes attributable to payments made by government entities under section 3402(t), §§31.6302–1 through 31.6302–3 apply with respect to the deposit of employment taxes attributable to payments made after December 31, 1992. Paragraph (e)(1)(iii)(E) of this section applies with respect to the deposit of employment taxes attributable to payments made by government entities under section 3402(t) after December 31, 2012. To the extent that the provisions of §§31.6302–1 through 31.6302–3 are inconsistent with the provisions of §§31.6302(c)–1 and 31.6302(c)–2, a taxpayer will be considered to be in compliance with §§31.6302–1 through 31.6302–3 if the taxpayer makes timely deposits during 1993 in accordance with §§31.6302(c)–1 and 31.6302(c)–2. Paragraphs (b)(4), (c)(5), (c)(6), (d) *Example 6*, (e)(2), (f)(4)(i), (f)(4)(iii), (f)(5) *Example 3*, and (g)(1) of this section apply to taxable years beginning on or after December 30, 2008. Paragraph (f)(4)(ii) of this section applies to taxable years beginning on or after January 1, 2010. The rules of paragraphs (e)(2) and (g)(1) of this section that apply to taxable years beginning before December 30, 2008, are contained in §31.6302–1 as in effect prior to December 30, 2008. The rules of paragraphs (b)(4), (c)(5), (c)(6), (d) *Example 6*, (f)(4)(i), (f)(4)(iii), and (f)(5) *Example 3* of this section that apply to taxable years beginning on or after

January 1, 2006, and before December 30, 2008, are contained in §31.6302–1T as in effect prior to December 30, 2008. The rules of paragraphs (b)(4) and (f)(4) of this section that apply to taxable years beginning before January 1, 2006, are contained in §31.6302–1 as in effect prior to January 1, 2006. The rules of paragraph (g) of this section eliminating use of Federal tax deposit coupons apply to deposits and payments made after December 31, 2010.

* * * * *

§31.6302–1T [Removed].

Par. 10. Section 31.6302–1T is removed.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved December 6, 2011.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on December 9, 2011 4:14 p.m., and published in the issue of the Federal Register for December 14, 2011, 76 F.R. 77672)

Section 6038D.—Returns and Records With Respect to Certain Fringe Benefit Plans

26 CFR 1.6038D–1T: Reporting with respect to specified foreign financial assets, definition of terms (temporary).

T.D. 9567

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Reporting of Specified Foreign Financial Assets

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the provisions of the Hiring Incentives to Restore Employment (HIRE) Act, Public Law 111–147 (124 Stat. 71) that require foreign financial assets to be reported to the Internal Revenue Service for taxable years beginning after March 18, 2010. In particular, the temporary regulations provide guidance relating to the requirement that individuals attach a statement to their income tax return to provide required information regarding foreign financial assets in which they have an interest. The temporary regulations affect individuals required to file Form 1040, *"U.S. Individual Income Tax Return,"* and certain individuals required to file Form 1040–NR, "*U.S. Nonresident Alien Income Tax Return.*" The text of these temporary regulations also serves as the text of proposed regulations contained in a cross-reference notice of proposed rulemaking (REG–130302–10) published in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on December 19, 2011.

Applicability Dates: For dates of applicability, see §§1.6038D–1T(b), 1.6038D–2T(e), 1.6038D–3T(e), 1.6038D–4T(b), 1.6038D–5T(g), 1.6038D–7T(d), and 1.6038D–8T(g).

FOR FURTHER INFORMATION CONTACT: Joseph S. Henderson, (202) 622–3880 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public comment pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and pending receipt and evaluation of public comments, approved by the Office of Management and Budget under Control Number 1545–2195. Responses to this collection of Information are mandatory.

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. The collection of information contained in these regulations is satisfied by filing Form 8938, *"Statement of Specified Foreign Financial Assets,"* OMB No. 1545–2195, with the respondent's income tax return.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

Books and 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

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) for reporting specified foreign financial assets under section 6038D of the Internal Revenue Code (Code).

Section 6038D was enacted by section 511 of the HIRE Act. Section 6038D(a) requires an individual who holds any interest in a specified foreign financial asset during the taxable year to attach a statement to that individual's return of tax imposed by subtitle A of the Code to report the information identified in section 6038D(c), if the aggregate value of the specified foreign financial assets in which the individual holds an interest exceeds $50,000 for the taxable year, or such higher dollar amount as the Secretary may prescribe.

Section 6038D(b) defines specified foreign financial assets. For purposes of section 6038D, a specified foreign financial asset is any financial account maintained by a foreign financial institution and, to the extent not held in an account at a financial institution: (i) any stock or security issued by any person other than a United States person; (ii) any financial instrument or contract held for investment that has an issuer or counterparty that is not a United States person; and (iii) any interest in a foreign entity.

Section 6038D(c) sets forth the information an individual must include on the statement reporting specified foreign financial assets. For a financial account, the name and address of the financial institution in which the account is maintained must be reported, as well as the account number. For any stock or security, the name and address of the non-U.S. issuer, as well as information necessary to identify the class or issue of which the stock or security is a part, must be reported. In the case of any other instrument, contract, or interest, the names and addresses of all issuers and counterparties must be reported, together with the information necessary to identify the instrument, contract, or interest. The maximum value of each specified foreign financial asset during the taxable year also must be reported.

An individual who fails to disclose the information required to be reported by section 6038D(c) is subject to a $10,000 penalty under section 6038D(d)(1). Section 6038D(d)(2) provides that if the failure to comply continues for more than 90 days after the day on which the Secretary mails notice of the failure to the individual, the individual must pay an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure to disclose continues after the expiration of the 90-day period. This continuation penalty is not to exceed $50,000 with respect to any such failure.

Under section 6038D(e), the aggregate value of any specified foreign financial assets in which an individual has an interest is presumed to exceed the reporting thresholds set forth in section 6038D(a) if the Secretary determines that the individual has an interest in one or more specified foreign financial assets and has not provided sufficient information to demonstrate the aggregate value of the assets. This presumption applies for purposes of assessing the penalties imposed under section 6038D.

Section 6038D(f) authorizes the Secretary to issue regulations or other guidance applying the provisions of section 6038D to any domestic entity as if the domestic entity were an individual, if the domestic entity is formed or availed of for the purposes of holding, directly or indirectly, specified foreign financial assets.

Section 6038D(g) provides that no penalty will be imposed by section 6038D for any failure to report that is shown to be due to reasonable cause and not due to willful neglect. A foreign law restriction, whether civil or criminal, on disclosing the information required to be reported is not reasonable cause.

Section 6038D(h) authorizes the Secretary to issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of section 6038D. This guidance may include appropriate exceptions from reporting for nonresident aliens, *bona fide* residents of U.S. possessions, and classes of assets identified by the Secretary, such as assets subject to duplicative reporting requirements. The term "U.S. possession" means American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands, each of which is generally referred to as a U.S. territory in this explanation.

Section 6038D is effective for taxable years beginning after March 18, 2010 (the date of enactment of the HIRE Act). Notice 2011–55, 2011–29 I.R.B. 53 (July 18, 2011), provides that an individual that has a taxable year that begins after March 18, 2010, and is required to attach a statement of specified foreign financial assets to an annual return to be filed prior to the issuance of Form 8938, "*Statement of Specified Foreign Financial Assets*," is to satisfy his or her obligation under section 6038D for such taxable year by attaching Form 8938 for such taxable year to his or her next annual return required to be filed after the issuance of Form 8938. *See §601.601(d)(2)(ii)(b) of this chapter*.

Explanation of Provisions

1. *Requirement to Report Specified Foreign Financial Assets*

Section 1.6038D–1T sets forth the definitions of certain terms for purposes of section 6038D and the regulations . Section 1.6038D–2T provides rules for determining if a specified individual (as defined in §1.6038D–1T(a)(2)) or a specified domestic entity (collectively referred to as a specified person) must file a Form 8938 with the specified person's annual return (as defined in §1.6038D–1T(a)(11)).

For purposes of section 6038D, a specified person's annual return includes an annual federal income tax return of a specified individual or an annual federal income tax return or information return of a specified domestic entity filed with the Internal Revenue Service under section 876, 6011, 6012, 6013, 6031, or 6037, and the regulations. For example, a partnership that is a specified domestic entity is required to attach Form 8938 to its Form 1065, *"U.S. Return of Partnership Income,"* for the taxable year.

A specified person must file Form 8938 if the person has an interest in one or more specified foreign financial assets and those assets have an aggregate fair market value exceeding either $50,000 on the last day of the taxable year or $75,000 at any time during the taxable year. Married specified individuals filing a joint annual return are not required to file Form 8938 unless the aggregate value of all of the specified foreign financial assets in which either spouse has an interest exceeds $100,000 on the last day of the taxable year or $150,000 at any time during the taxable year.

An individual residing outside the United States can reasonably be expected to have a greater amount of specified foreign financial assets for reasons unrelated to the policies underlying section 6038D. Accordingly, the regulations increase the reporting threshold of section 6038D(a) in the case of a specified individual who is a qualified individual under section 911(d)(1). The regulations provide that such a specified individual is not required to file Form 8938 unless the aggregate value of the specified foreign financial assets in which the specified individual has an interest exceeds $200,000 on the last day of the taxable year or $300,000 at any time during the taxable year. If married specified individuals file a joint annual return and either spouse is a qualified individual under section 911(d)(1), the regulations provide that they are not required to file Form 8938 unless the aggregate value of all of the specified foreign financial assets in which either spouse has an interest exceeds $400,000 on the last day of the taxable year or $600,000 at any time during the taxable year.

As discussed in section 6 of this explanation, certain specified foreign financial assets are excepted from the reporting obligations imposed under section 6038D. Assets reported by a specified person on certain other forms timely filed with the Internal Revenue Service are not required to be separately identified on Form 8938, but if a specified person is required to file Form 8938, the number of such other forms filed with the Internal Revenue Service must be reported on Form 8938. In addition, the value of specified foreign financial assets that qualify for this exception is included for purposes of determining whether the aggregate value of specified foreign financial assets in which a specified individual has an interest exceeds the applicable reporting threshold.

Another category of assets excepted from reporting are assets considered owned by a specified person that is treated as the owner of certain trusts. Additionally, certain assets held by a specified individual who is a *bona fide* resident of a U.S. territory are also excepted from reporting. Specified foreign financial assets that qualify for either of these two exceptions are not included for purposes of determining whether the aggregate value of specified foreign financial assets in which a specified person has an interest exceeds the applicable reporting threshold.

The Form 8938 reporting period is the taxable year for a specified individual who is a U.S. citizen, a resident alien, or a *bona fide* resident of a U.S. territory for the entire taxable year. The Form 8938 reporting period for a specified domestic entity is the entity's taxable year. The Form 8938 reporting period for a specified individual who is a U.S. citizen or resident alien for less than the entire taxable year is the portion of the taxable year for which the specified individual is a U.S. citizen or resident alien. The Form 8938 reporting period for a specified individual who is *bona fide* resident of Puerto Rico for less than the entire taxable year under §1.937–1(f)(2)(ii) is the portion of the taxable year for which the specified individual is a U.S. citizen.

A specified person is not required to file Form 8938 for any taxable year for which the specified person is not required to file an annual return (for example, a Form 1040, *"U.S. Individual Income Tax Return,"* Form 1041, *"U.S. Income Tax Return for Estates and Trusts,"* Form 1120, *"U.S. Corporation Income Tax Return,"* Form 1120–S, "*U.S. Income Tax Return for an S Corporation*," or Form 1065, *"U.S. Return of Partnership Income")* with the Internal Revenue Service.

If a specified domestic entity is a member of an affiliated group of corporations that files a consolidated return, the Form 8938 of the specified domestic entity must be filed with the consolidated federal income tax return of the affiliated group.

A. *Individuals required to file Form 8938, "Statement of Specified Foreign Financial Assets"*

For section 6038D purposes, a specified individual is a U.S. citizen, a resident alien of the United States (as determined under section 7701(b) and §§301.7701(b)–1 through 301.7701(b)–9 of this chapter), or a nonresident alien who has elected under section 6013(g) or (h) to be taxed as a U.S. resident. A resident alien who elects to be taxed as a resident of a foreign country pursuant to a U.S. income tax treaty's residency tie-breaker rules is a specified individual for purposes of section 6038D and the regulations.

In addition, certain nonresident aliens who are treated as residents under other sections of the Code are specified individuals for the purposes of section 6038D and the regulations. Under section 876 and §1.876–1, nonresident alien individuals of the United States under section 7701(b) who are *bona fide* residents of Puerto Rico or a section 931 possession (as defined in §1.931–1(c)(1)) are subject to tax under sections 1 and 55 in generally the same manner as a U.S. resident. Therefore, the rules under section 6038D apply to a nonresident alien who is a *bona fide* resident of Puerto Rico or American Samoa in the same manner as they apply to a U.S. citizen or resident.

As noted in this preamble, a specified person is not required to file Form 8938 if the specified person is not required to file an annual return with the Internal Revenue Service. With respect to *bona fide* residents of U.S. territories, this rule means that a *bona fide* resident of a U.S. territory has a filing requirement under section 6038D and the regulations only if he or she is required to file a federal income tax return for the taxable year. In general, *bona fide* residents of the U.S. Virgin Islands and U.S. territories to which section 935 applies (currently, Guam and the Northern Mariana Islands) are not required to file a federal income tax return provided they correctly report and pay tax on their worldwide income to their U.S. territory taxing authority. *Bona fide* residents of Puerto Rico or a section 931 possession (currently, American Samoa) generally are required to file a federal income tax return with the Internal Revenue Service only if they have income from sources without the relevant U.S. territory, because sections 931(a) and 933 generally exclude from gross income any income derived from sources within the relevant U.S. territory. Section 6038D and these regulations generally require only *bona fide* residents of Puerto Rico or a section 931 possession that are required to file a federal income tax return with the Internal Revenue Service to file a Form 8938 with the Internal Revenue Service.

B. *Interest in a specified foreign financial asset*

For section 6038D purposes, a specified person is generally considered to have an interest in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to the holding or disposition of the asset are or would be required to be reported, included, or otherwise reflected on the specified person's annual return filed with the Internal Revenue Service (even if no income, gains, losses, deductions, credits, gross proceeds, or distributions are attributable to the asset for a particular taxable year).

For purposes of section 6038D and the regulations, a parent that makes an election under section 1(g)(7) to include certain unearned income of a child in the parent's gross income required to be reported for the taxable year has an interest in any specified foreign financial asset held by the child.

A specified person that is the owner of an entity disregarded as an entity separate from its owner (as provided in §301.7701–2(c)(2)(i) of this chapter) (disregarded entity) is treated as having an interest in any specified foreign financial assets held by the disregarded entity. A specified person that is treated as the owner of a trust or any portion of a trust under sections 671 through 679 is treated as having an interest in any specified foreign financial assets held by the trust or by the portion of the trust that the specified person owns, except as described in section 6(B) of this explanation. A specified person is not treated as having an interest in any specified foreign financial assets held by a partnership, corporation, trust (except as described in this explanation), or estate solely as a result of the specified person's status as a partner, shareholder, or beneficiary.

C. *Jointly owned assets*

A joint interest in a specified foreign financial asset is subject to reporting under section 6038D and §1.6038D–2T(a) by each specified person that is a joint owner of the asset. In general, each joint owner includes the full value of the jointly owned asset for purposes of determining whether the aggregate value of all specified foreign financial assets in which the joint owner has an interest exceeds the reporting thresholds set forth in §1.6038D–2T(a).

1. *Married individuals filing jointly*

Married specified individuals who file a joint annual return for the taxable year must fulfill their reporting requirements under section 6038D and §1.6038D–2T(a) by filing a single Form 8938 that reports all of the specified foreign financial assets in which either married specified individual has an interest. A specified foreign financial asset that is jointly owned by married specified individuals or a specified foreign financial asset held by a child for which the married specified individuals have made an election under section 1(g)(7) is reported once on the single Form 8938. Married specified individuals who file a joint annual return include the value of a specified foreign financial asset that they jointly own together or a specified foreign financial asset held by a child for which they have made an election under section 1(g)(7) only once in determining whether the aggregate value of all of the specified foreign financial assets in which either married specified individual has an interest exceeds the appropriate reporting threshold set forth in §1.6038D–2T(a).

2. *Married individuals filing separately*

A married specified individual who files a separate annual return for the taxable year must fulfill the reporting requirements under section 6038D and §1.6038D–2T(a) by filing a separate Form 8938 that reports all of the specified foreign financial assets in which the married specified individual has an interest, including assets jointly owned with the married specified individual's spouse. A married specified individual that files a separate annual return and whose spouse is a specified person includes only one-half of the value of a specified foreign financial asset that the married specified individual jointly owns with his or her spouse in determining whether the married specified individual has an interest in specified foreign financial assets the aggregate value of which exceeds the appropriate reporting threshold set forth in §1.6038D–2T(a).

2. *Specified Foreign Financial Assets*

For purposes of section 6038D, specified foreign financial assets include financial accounts maintained by foreign financial institutions, as well as certain other foreign financial assets or instruments. An asset or instrument may be a specified foreign financial asset subject to reporting under section 6038D and the regulations even if the asset or instrument does not have a positive value.

A. *Financial account maintained by a foreign financial institution*

For purposes of section 6038D, a financial account is defined by reference to section 1471(d)(2) and the regulations.

A foreign financial institution is defined by reference to section 1471(d)(4). For this purpose, a foreign financial institution is a financial institution (as determined under section 1471(d)(5)) that is a foreign entity (as determined under section 1473(5)). Under section 1471(d)(5), a financial institution is any entity that—

(1) Accepts deposits in the ordinary course of a banking or similar business;

(2) Holds financial assets for the account of others as a substantial portion of its business; or

(3) Is engaged, or holds itself out as being engaged, primarily in the business of investing, reinvesting, or trading in securities (as defined in section 475(c)(2) without regard to the last sentence thereof), partnership interests, commodities (as defined in section 475(e)(2)), or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.

Notwithstanding that a financial institution organized under the laws of a U.S. territory is not generally a foreign financial institution for purposes of section 1471(d)(4), for purposes of section 6038D and the regulations, a specified foreign financial asset includes a financial account maintained by a financial institution organized under the laws of a U.S. territory. Accordingly, such an account must be reported, except when owned by a *bona fide* resident of the relevant U.S. territory.

A financial account maintained by a U.S. payor as defined in §1.6049–5(c)(5)(i) (including assets held in such an account) is not a specified foreign financial asset for purposes of section 6038D and the regulations thereunder. For example, a specified person is not required to report a financial account maintained by a U.S. branch of a foreign financial institution described in §1.1441–1(b)(2)(iv).

An asset held in a financial account maintained by a foreign financial institution is not required to be reported on Form 8938 separately from the reported financial account in which the asset is held. The value of an asset held in a financial account maintained by a foreign financial institution is included in determining the maximum value of that account.

B. *Other specified foreign financial assets*

Under §1.6038D–3T(b), specified foreign financial assets also include certain assets that are held outside of a financial account maintained by a financial institution. Specifically, a specified foreign financial asset includes any asset that is held for investment and is described in one or more of the following three categories: stock or securities issued by a person other than a U.S. person; a financial instrument or contract issued by a person other than a U.S. person or that has a counterparty that is a person other than a U.S. person; and any interest in a foreign entity. For these purposes, a U.S. person is defined under section 7701(a)(30). Whether an entity is a foreign entity is determined under section 1473(5). These three categories are broad and overlap in certain cases such that an asset not held in a financial account may be within more than one of the statutory categories of section 6038D(b)(2). For example, stock issued by a foreign corporation is stock that is issued by a person other than a U.S. person, and is also an interest in a foreign entity.

An asset not held in an account maintained by a financial institution is held for investment for purposes of section

6038D and the regulations if the asset is not used or held for use in the specified person's trade or business. For purposes of determining whether an asset is used or held for use in the specified person's trade or business, the regulations apply principles based on the asset-use test of §1.864–4(c)(2), with certain modifications. The regulations provide that stock is never considered to be used or held for use in a trade or business in applying the trade or business exception. The Department of the Treasury and the Internal Revenue Service believe this rule is appropriate given the broad exception for section 475 mark-to-market accounting discussed in section 2(D) of this explanation, and the exception from reporting for stock held in a financial account maintained by a foreign financial institution (provided the financial account is reported on Form 8938). The Department of the Treasury and the Internal Revenue Service request comments that concern the treatment of stock under these regulations and, more generally, what refinements, if any, to the regulation's trade or business standard would facilitate the implementation of the trade or business reporting exception.

C. *Special rule for foreign estates and foreign trusts*

A beneficial interest in a foreign trust or a foreign estate is not a specified foreign financial asset of a specified person unless the specified person knows or has reason to know based on readily accessible information of the interest. Receipt of a distribution from the foreign trust or foreign estate is deemed for this purpose to be actual knowledge of the interest.

D. *Assets not subject to reporting under section 6038D*

The following assets are not specified foreign financial assets —

(1) An asset for which a specified person uses mark-to-market accounting under section 475;

(2) A financial account maintained by a foreign financial institution for which the specified person uses mark-to-market accounting under section 475 for all of the holdings in the account; and

(3) An interest in a social security, social insurance, or other similar program of a foreign government.

3. *Required Information*

A specified person required to report on Form 8938 must provide the following information with regard to each specified foreign financial asset:

(A) In the case of a financial account maintained by a foreign financial institution, the name and address of the foreign financial institution and the account number of the account;

(B) In the case of stock or a security, the name and address of the issuer, and information that identifies the class or issue of which the stock or security is a part;

(C) In the case of a financial instrument or contract held for investment, information that identifies the financial instrument or contract, including the names and addresses of all issuers and counterparties;

(D) In the case of an interest in a foreign entity, information that identifies the interest, including the name and address of the entity;

(E) The maximum value of the specified foreign financial asset during the portion of the taxable year in which the specified person has an interest in the asset;

(F) In the case of a financial account that is a depository or custodial account under section 1471(d)(2), whether such financial account was opened or closed during the taxable year;

(G) The date, if any, on which the specified foreign financial asset, other than a financial account that is a depository or custodial account under section 1471(d)(2), was either acquired or disposed of (or both) during the taxable year;

(H) The amount of any income, gain, loss, deduction, or credit recognized for the taxable year with respect to the reported specified foreign financial asset, and the schedule, form, or return filed with the Internal Revenue Service on which the income, gain, loss, deduction, or credit, if any, is reported or included by the specified person;

(I) The foreign currency exchange rate and, if the source of such rate is other than as described in §1.6038D–5T(d)(1), the source of the rate used to determine the specified foreign financial asset's U.S. dollar value, including maximum value; and

(J) For a specified foreign financial asset excepted from reporting on Form 8938 under §1.6038D–7T(a), the specified person must report the number of each type of form on which the asset is reported directly (for example, Form 3520, *"Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts,"* Form 3520–A, *"Annual Information Return of Foreign Trust With a U.S. Owner,"* Form 5471,*"Information Return of U.S. Persons With Respect To Certain Foreign Corporations,"* Form 8621, *"Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund,"* Form 8865, *"Return of U.S. Persons With Respect to Certain Foreign Partnerships,"* or Form 8891, *"U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans."*)

4. *Valuation Guidelines*

The value of a specified foreign financial asset must be determined both for purposes of determining if the aggregate value of the specified foreign financial assets in which a specified person holds an interest exceeds the reporting thresholds set forth in §1.6038D–2T(a) and for purposes of reporting the maximum value of a specified foreign financial asset on Form 8938 as required by §1.6038D–4T(a)(5). Under §1.6038D–5T, the value of a specified foreign financial asset for both of these purposes generally is the asset's fair market value. The maximum value of a specified foreign financial asset is the asset's highest fair market value during the taxable year, except as otherwise provided in §1.6038D–5T, and must be reported on Form 8938 in U.S. dollars. If the maximum value of a specified foreign financial asset is less than zero, the value of the specified foreign financial asset is treated as zero for the purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest and determining the maximum value of a specified foreign financial asset required to be reported on Form 8938.

A. Foreign currency conversion

If a specified foreign financial asset is denominated in a foreign currency, the value of the asset for purposes of determining both the aggregate value of specified foreign financial assets in which a specified person holds an interest and the maximum value of the specified foreign financial asset is first determined in the foreign currency prior to conversion into U.S. dollars (that is, independently of exchange rate fluctuations during the year). The asset's foreign currency value is then converted into U.S. dollars at the taxable year-end spot rate for converting the foreign currency into U.S. dollars (that is, the rate to purchase U.S. dollars). The U.S. Treasury Department's Financial Management Service foreign currency exchange rate is to be used to convert the value of a specified foreign financial asset into U.S. dollars. If no U.S. Treasury Department Financial Management Service foreign currency exchange rate is available, another publicly available foreign currency exchange rate may be used to determine an asset's maximum value, but the use of such rate must be disclosed on Form 8938.

B. *Valuing financial accounts*

The maximum value of a financial account means a reasonable estimate of the maximum value of the holdings of the financial account at any time during the taxable year. Periodic account statements provided at least annually may be relied upon for reporting a financial account's maximum value absent actual knowledge or reason to know based on readily accessible information that the statements do not reflect a reasonable estimate of the maximum account value during the taxable year.

C. *Valuing other specified foreign financial assets*

Except as described in sections 4(D) and 4(E) of this explanation, for purposes of determining the maximum value of a specified foreign financial asset other than a financial account maintained with a foreign financial institution, a specified person may treat the asset's fair market value on the last day during the taxable year on which the specified person has an interest in the asset as the maximum value of the asset. The specified person may not use this valuation approach if the specified person has actual knowledge or reason to know based on readily accessible information that the fair market value determined as of such date does not reflect a reasonable estimate of the maximum value of the asset during the year (for example, because there is a reason to know that the asset's value declined significantly during the year).

A specified person may determine the fair market value of a specified foreign financial asset based on information publicly available from reliable financial information sources or from other verifiable sources. Even if there is no information from reliable financial information sources regarding the fair market value of a reported asset, the regulations do not require a specified person to obtain an appraisal by a third party in order to reasonably estimate the asset's fair market value.

D. *Special valuation rules for interests in foreign trusts*

If a specified person is a beneficiary of a foreign trust, the maximum value of the specified person's interest in the trust is the sum of the fair market value, determined as of the last day of the taxable year, of all of the currency or other property distributed from the foreign trust during the taxable year to the specified person, plus the value as of the last day of the taxable year of the specified person's right as a beneficiary to receive mandatory distributions from the foreign trust as determined under section 7520.

For purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest, if the specified person does not know or have reason to know based on readily accessible information the fair market value of the person's interest in a foreign trust during the taxable year, the value to be included in determining the aggregate value of the specified foreign financial assets is the maximum value of the specified person's interest in the foreign trust.

E. *Special valuation rule for interests in foreign estates, pension plans, and deferred compensation plans*

The maximum value of a specified person's interest in a foreign estate, foreign pension plan, or a foreign deferred compensation plan is the fair market value, determined as of the last day of the taxable year, of the specified person's beneficial interest in the assets of the foreign estate, foreign pension plan, or foreign deferred compensation plan. If the specified person does not know or have reason to know based on readily accessible information such fair market value, the maximum value to be reported is the fair market value, determined as of the last day of the taxable year, of the currency and other property distributed during the taxable year to the specified person as a beneficiary or participant.

For purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest, if the specified person does not know or have reason to know based on readily accessible information the fair market value of the person's interest in a foreign estate, foreign pension plan, or foreign deferred compensation plan during the taxable year, the value to be included in determining the aggregate value of the specified foreign financial assets is the fair market value, determined as of the last day of the taxable year, of the currency and other property distributed during the taxable year to the specified person as a beneficiary or participant.

F. *Jointly owned assets*

Except for certain married specified individuals who jointly own a specified foreign financial asset with a spouse, a specified person that jointly owns a specified foreign financial asset must use the value of the entire asset, and not the value of the specified person's separate interest, for purposes of determining whether the reporting thresholds set forth in §1.6038D–2T(a) are exceeded. A specified person, including a married specified individual, that jointly owns a specified foreign financial asset must report the maximum value of the entire asset during the portion of the taxable year that the specified person has an interest in the asset. Married specified individuals that jointly own a specified foreign financial asset and that file a joint annual income return tax are only required to report the asset once on the single Form 8938 filed with their return.

5. *Application to Entities Formed or Availed of for Purposes of Holding, Directly or Indirectly, Specified Foreign Financial Assets*

The notice of proposed rulemaking accompanying these regulations (REG–130302–10) includes Prop. Reg.

§1.6038D–6, which applies section 6038D to certain domestic entities that are formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets. The Department of the Treasury and the Internal Revenue Service anticipate that Prop. Reg. §1.6038D–6 will be issued as a final regulation during 2012 and will apply to taxable years beginning after December 31, 2011. Until Prop. Reg. §1.6038D–6 is issued as a final regulation, no domestic entity is required to file Form 8938 to report specified foreign financial assets with its annual return.

6. *Exceptions from the Application of Section 6038D*

A. *Duplicative reporting of assets*

A specified person required to file Form 8938 with the Internal Revenue Service is not required to report a specified foreign financial asset on Form 8938 if the asset is reported or reflected on a Form 3520 (in the case of a specified person who is the beneficiary of a foreign trust), Form 5471, Form 8621, Form 8865, or Form 8891 timely filed with the Internal Revenue Service by the specified person for the taxable year, and the Form 8938 indicates the filing of the form on which the asset is reported.

A specified person required to file Form 8938 that is treated as an owner of a foreign trust or any portion of such a trust under sections 671 through 679 is not required to report any specified foreign financial asset held by the trust on Form 8938 provided the specified person reports the trust on a Form 3520 timely filed with the Internal Revenue Service for the taxable year, the trust timely files Form 3520–A with the Internal Revenue Service for the taxable year, and the Form 8938 filed by the specified person for the taxable year indicates the filing of the Form 3520 and the Form 3520–A.

B. *Owner of certain trusts*

A specified person that is treated as an owner of a domestic liquidating trust described in §301.7701–4(d) of this chapter created pursuant to a court order issued in a bankruptcy under Chapter 7 (11 U.S.C. 701 *et seq.*) or a confirmed plan under Chapter 11 (11 U.S.C. 1101 *et seq.*) of the Bankruptcy Code, a domestic widely held fixed investment trust under §1.671–5, or any portion of such a trust under sections 671 through 679 is not required to file Form 8938 to report any specified foreign financial asset held by the trust.

C. *Certain specified foreign financial assets held by a bona fide resident of a U.S. territory*

As described in section 1(A) of this explanation, *bona fide* residents of the U.S. Virgin Islands and U.S. territories to which section 935 applies (currently, Guam and the Northern Mariana Islands) generally are not required to file a federal income tax return and, therefore, generally would not be required to file a Form 8938 with the Internal Revenue Service. By contrast, certain *bona fide* residents of Puerto Rico or a section 931 possession as defined in §1.931–1(c)(1) (currently, American Samoa) who have income from sources outside their U.S. territory of residence may be required to file a federal income tax return; thus, the reporting requirements of section 6038D and the regulations may apply to such persons.

No reporting is required by a *bona fide* resident of a U.S. territory with respect to certain specified foreign financial assets that have certain connections to the U.S. territory of which the individual is a *bona fide* resident. Reporting is not required with respect to a financial account maintained by a financial institution organized under the laws of the U.S. territory of which the specified person is a *bona fide* resident. Reporting also is not required with respect to a financial account maintained by a branch of a financial institution not organized under the laws of the U.S. territory of which the specified person is a *bona fide* resident, if the branch is subject to the same income tax and information reporting requirements applicable to a financial institution organized under the laws of the U.S. territory.

Reporting is also not required with respect to stock or securities or any other interest in an entity organized under the laws of the U.S. territory of which the specified person is a *bona fide* resident. Similarly, reporting is not required with respect to a financial instrument or contract held for investment if the issuer or counterparty is: (i) an entity organized under the laws of the U.S. territory of which the specified person is a *bona fide* resident; or (ii) a *bona fide* resident of the U.S. territory of which the specified person is a *bona fide* resident.

These reporting exceptions for certain U.S. territory-connected assets do not apply to assets held by a U.S. citizen or resident who is not a *bona fide* resident of any U.S. territory or an individual who is a *bona fide* resident of a U.S. territory other than the one to which the assets are connected.

D. *Form TD F 90–22.1, "Report of Foreign Bank and Financial Accounts" (FBAR)*

Reporting on Form TD F 90–22.1 is required under Title 31 (31 U.S.C. 5314) for other law enforcement purposes in addition to tax administration. As a consequence, different policy considerations apply to Form 8938 and FBAR reporting. These are reflected in the different categories of persons required to file Form 8938 and the FBAR, the different filing thresholds for Form 8938 and FBAR reporting, and the different assets (and accompanying information) required to be reported on each form. Although certain information may be reported on both Form 8938 and the FBAR, the information required by the forms is not identical in all cases, and reflects the different rules, key definitions (for example, "financial account"), and reporting requirements applicable to Form 8938 and FBAR reporting.

These differing policy considerations were recognized during the passage of the HIRE Act and the enactment of section 6038D, and the intention to retain FBAR reporting notwithstanding the enactment of section 6038D was specifically noted in the Technical Explanation Of The Revenue Provisions Contained In Senate Amendment 3310, The "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate (Staff of the Joint Comm. on Taxation, JCX–4-10 (February 23, 2010)) (Technical Explanation) accompanying the HIRE Act. The Technical Explanation states that "[n]othing in this provision [section 511 of the HIRE Act enacting section 6038D] is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision." (Technical

Explanation at p. 60). Against this background, reporting on Form 8938 and the FBAR is not duplicative and both forms must be filed, if required.

7. *Penalties for Failure to Disclose*

A. *In general*

If a specified person fails to file a Form 8938 that includes the information required by section 6038D(c) and §1.6038D–4T with respect to any taxable year at the time and in the manner described in section 6038D(a) and §1.6038D–2T, a penalty of $10,000 will apply to that specified person under section 6038D(d) and §1.6038D–8T. If any such failure continues for more than 90 days after the day on which the Commissioner or his delegate mails a notice of the failure to the specified person required to file the Form 8938, the specified person is subject to an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure continues after the 90-day period has expired. The additional (or continuation) penalty is limited to a maximum of $50,000 for each such failure.

Married specified individuals who file a joint annual return and fail to file a required Form 8938, *"Statement of Specified Foreign Financial Assets,"* that includes the information required by section 6038D(c) and §1.6038D–4T with respect to any taxable year at the time and in the manner described in section 6038D(a) and §1.6038D–2T are subject to penalties under section 6038D(d) and §1.6038D–8T as if the married specified individuals are a single specified person. The liability of married specified individuals who file a joint annual return with respect to penalties under this section is joint and several.

B. *Presumption of aggregate value*

For the purpose of assessing the penalties for failure to disclose, if the Commissioner or his delegate determines that a specified person has an interest in one or more specified foreign financial assets, and the specified person has not provided sufficient information to demonstrate the aggregate value of the assets upon request by the Secretary, then the aggregate value of the assets is treated as being in excess of the applicable reporting threshold set forth in §1.6038D–2T(a).

C. *Reasonable cause exception*

If a specified person shows that the failure to report the information required under section 6038D and §1.6038D–4T is due to reasonable cause and not due to willful neglect, no penalty will be imposed under section 6038D(d) or §1.6038D–8T. To show that the failure to report is due to reasonable cause and not due to willful neglect, the specified person must make an affirmative showing of all the facts alleged as reasonable cause for the failure to report.

The determination of whether a failure to disclose a specified foreign financial asset on Form 8938 was due to reasonable cause and not due to willful neglect is made on a case-by-case basis, taking into account all pertinent facts and circumstances. For this purpose, the fact that a foreign jurisdiction would impose a civil or criminal penalty on the specified person (or any other person) for disclosing the required information is not reasonable cause.

Special Analyses

It has been determined that this Treasury decision 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. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section of the preamble to the cross-referenced notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Joseph S. Henderson, Office of Associate Chief Counsel (International). However, other personnel from the Internal Revenue Service and the Treasury Department participated in the development of the regulations.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.6038D–0T also issued under 26 U.S.C. 6038D.

Section 1.6038D–1T also issued under 26 U.S.C. 6038D.

Section 1.6038D–2T also issued under 26 U.S.C. 6038D.

Section 1.6038D–3T also issued under 26 U.S.C. 6038D.

Section 1.6038D–4T also issued under 26 U.S.C. 6038D.

Section 1.6038D–5T also issued under 26 U.S.C. 6038D.

Section 1.6038D–7T also issued under 26 U.S.C. 6038D.

Section 1.6038D–8T also issued under 26 U.S.C. 6038D.* * *

Par. 2. Section 1.6038D–0T is added to read as follows:

§1.6038D–0T Outline of regulation provisions (temporary).

This section lists the table of contents for §§1.6038D–1T through 1.6038D–8T.

(b) Effective/applicability dates.
(c) Expiration date.

§1.6038D–2T Requirement to report specified foreign financial assets (temporary).

(a) Reporting requirement.
(1) In general.
(2) Special rule for married specified individuals filing a joint annual return.
(3) Special rule for certain specified individuals living abroad.
(4) Special rule for qualified individuals filing a joint annual return.
(5) Assets with no positive value.
(6) Excepted assets.
(7) Form 8938 filed with annual return.
(i) General rule.
(ii) Consolidated returns.
(8) Reporting required regardless of tax result.
(9) Reporting period.
(10) Successor forms.
(b) Interest in a specified foreign financial asset.
(1) In general.
(2) Special rule for parent making an election under section 1(g)(7).
(3) Entities.
(c) Special rules for joint interests.
(1) Aggregate value of assets.
(i) Specified persons.
(ii) Married specified individuals.
(2) Annual return filed by married specified individual.
(i) Joint annual return.
(ii) Separate annual return.
(d) Example.
(1) Facts.
(2) Filing requirement.
(i) Married specified individuals filing separate annual returns.
(ii) Married specified individuals filing a joint annual return.
(e) Effective/applicability dates.
(f) Expiration date.

§1.6038D–3T Specified foreign financial assets (temporary).

(a) Financial accounts.
(1) In general.
(2) Financial account in a U.S. possession.
(3) Excepted financial accounts.
(i) Accounts maintained by U.S. payors.
(ii) Mark-to-market election under section 475.
(b) Other specified foreign financial assets.
(1) In general.
(2) Mark-to-market election under section 475.
(3) Held for investment.
(4)Trade-or-business test.
(5) Direct relationship between holding an asset and a trade or business.
(i) In general.
(ii) Presumption of direct relationship.
(c) Special rule for interests in foreign trusts and foreign estates.
(d) Examples.
(e) Effective/applicability dates.
(f) Expiration date.

§1.6038D–4T Information required to be reported (temporary).

(a) Required information.
(b) Effective/applicability dates.
(c) Expiration date.

§1.6038D–5T Valuation guidelines (temporary).

(a) Fair market value.
(b) Valuation of assets.
(1) Maximum value.
(2) U.S. dollars.
(3) Asset with no positive value.
(c) Foreign currency conversion.
(1) In general.
(2) Other publicly available exchange rate.
(3) Currency exchange rate.
(4) Determination date.
(d) Financial accounts.
(e) Asset held in a financial account.
(f) Other specified foreign financial assets.
(1) General rule.
(2) Interests in trusts that are specified foreign financial assets.
(i) Maximum value.
(ii) Reporting threshold.
(3) Interests in estates, pension plans, and deferred compensation plans.
(i) Maximum value.
(ii) Reporting threshold.
(g) Effective/applicability dates.
(h) Expiration date.

§1.6038D–6T Specified domestic entities (temporary). [Reserved]

§1.6038D–7T Exceptions from the reporting of certain assets under Section 6038D (temporary).

(a) Elimination of duplicative reporting of assets.
(1) In general.
(2) Foreign grantor trusts.
(b) Owner of certain trusts.
(c) *Bona fide* resident of a U.S. possession.
(d) Effective/applicability dates.
(e) Expiration date.

§1.6038D–8T Penalties for failure to disclose (temporary).

(a) In general.
(b) Married specified individuals filing a joint annual return.
(c) Increase in penalty.
(d) Presumption of aggregate value.
(e) Reasonable cause exception.
(1) In general.
(2) Affirmative showing required.
(3) Facts and circumstances taken into account.
(f) Penalties for underpayments attributable to undisclosed foreign financial assets.
(1) Accuracy related penalty.
(2) Criminal penalties.
(g) Effective/applicability dates.
(h) Expiration date.

Par. 3. Section 1.6038D–1T is added to read as follows:

§1.6038D–1T Reporting with respect to specified foreign financial assets, definition of terms (temporary).

(a) *In general*. The following definitions apply for purposes of section 6038D and the regulations —

(1) *Specified person*. The term *specified person* means a specified individual or a specified domestic entity.

(2) *Specified individual*. The term *specified individual* means an individual who is a —

(i) U.S. citizen;

(ii) Resident alien of the United States for any portion of the taxable year;

(iii) Nonresident alien for whom an election under section 6013(g) or (h) is in effect; or

(iv) Nonresident alien who is a *bona fide* resident of Puerto Rico or a section 931 possession (as defined in §1.931–1(c)(1)).

(3) *Resident alien*. The term *resident alien* has the meaning set forth in section 7701(b) and §§301.7701(b)–1 through 301.7701(b)–9 of this chapter.

(4) *Bona fide resident of a U.S. possession.* The term *bona fide resident of a U.S. possession* means an individual who is a *"bona fide* resident" under section 937(a) and §1.937–1.

(5) *U.S. possession*. The term *U.S. possession* means American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands.

(6) *Specified foreign financial asset*. The term *specified foreign financial asset* has the meaning set forth in §1.6038D–3T.

(7) *Financial account*. The term *financial account* has the meaning set forth in section 1471(d)(2) and the regulations.

(8) *Financial institution*. The term *financial institution* has the meaning set forth in section 1471(d)(5) and the regulations.

(9) *Foreign financial institution*. The term *foreign financial institution* has the meaning set forth in section 1471(d)(4) and the regulations .

(10) *Foreign entity*. The term *foreign entity* has the meaning set forth in section 1473(5) and the regulations .

(11) *Annual return*. The term *annual return* means an annual federal income tax return of a specified individual or an annual federal income tax return or information return of a specified domestic entity filed with the Internal Revenue Service under section 876, 6011, 6012, 6013, 6031, or 6037, and the regulations.

(12) *Specified domestic entity*. — [Reserved].

(b) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(c) *Expiration date*. The applicability of this section expires December 12, 2014.

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

§1.6038D–2T Requirement to report specified foreign financial assets (temporary).

(a) *Reporting requirement*—(1) *In general*. Except as otherwise provided, a specified person that has any interest in a specified foreign financial asset during the taxable year must attach Form 8938, *"Statement of Specified Foreign Financial Assets,"* to that specified person's annual return for the taxable year to report the information required by section 6038D and §1.6038D–4T if the aggregate value of all such assets exceeds—

(i) $50,000 on the last day of the taxable year; or

(ii) $75,000 at any time during the taxable year.

(2) *Special rule for married specified individuals filing a joint annual return*. Except as provided in paragraph (a)(1)(4) of this section, married specified individuals that file a joint annual return for the taxable year must attach a single Form 8938 to their joint annual return to report the information required by section 6038D and §1.6038D–4T if the aggregate value of all of the specified foreign financial assets in which either married specified individual has an interest exceeds—

(i) $100,000 on the last day of the taxable year; or

(ii) $150,000 at any time during the taxable year.

(3) *Special rule for certain specified individuals living abroad*. Except as provided in paragraph (a)(1)(4) of this section, a specified individual who is a qualified individual under section 911(d)(1) for the taxable year is required to attach a Form 8938 to the specified individual's annual return and report the information required by section 6038D and §1.6038D–4T if the aggregate value of the specified foreign financial assets in which the specified individual has an interest exceeds—

(i) $200,000 on the last day of the taxable year; or

(ii) $300,000 at any time during the taxable year.

(4) *Special rule for qualified individuals filing a joint annual return*. A qualified individual under section 911(d)(1) and the qualified individual's spouse who file a joint annual return must attach Form 8938 to their joint annual return to report the information required by section 6038D and §1.6038D–4T if the aggregate value of the all of the specified foreign financial assets in which either married individual has an interest exceeds—

(i) $400,000 on the last day of the taxable year; or

(ii) $600,000 at any time during the taxable year.

(5) *Assets with no positive value*. A specified foreign financial asset is subject to reporting even if the specified foreign financial asset does not have a positive value. See §1.6038D–5T(b) for reporting the maximum value of a specified foreign financial asset, including a specified foreign financial asset that does not have a positive value during the taxable year.

(6) *Excepted assets*. The value of any specified foreign financial asset in which a specified individual has an interest and that is excluded from reporting on Form 8938 pursuant to §1.6038D–7T(a) is included for purposes of determining the aggregate value of specified foreign financial assets. The value of any specified foreign financial asset in which a specified individual has an interest and that is excluded from reporting under §1.6038D–7T(b) or (c) is excluded for purposes of determining the aggregate value of specified foreign financial assets.

(7) *Form 8938 filed with annual return*— (i) *General rule*. A specified person, including a specified individual who is a *bona fide* resident of a U.S. possession, is not required to file Form 8938 with respect to a taxable year if the specified person is not required to file an annual return with the Internal Revenue Service with respect to such taxable year.

(ii) *Consolidated returns*. If a specified domestic entity is a member of an affiliated group of corporations that files a consolidated income tax return, the Form 8938 of the specified domestic entity must be filed with the affiliated group's annual return.

(8) *Reporting required regardless of tax result*. The Form 8938 required by section 6038D and this section must be furnished by a specified person even if none of the specified foreign financial assets that must be reported affect the specified person's tax liability under the Internal Revenue Code for the taxable year.

(9) *Reporting period*. The reporting period covered by Form 8938 is the specified person's taxable year, except the reporting period for a specified person who is a spec-

ified individual for less than an entire taxable year is the portion of the taxable year that the specified person is a specified individual.

(10) *Successor forms*. References to Form 8938 include any successor form.

(b) *Interest in a specified foreign financial asset*— (1) *In general*. A specified person has an interest in a specified foreign financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to the holding or disposition of the specified foreign financial asset are or would be required to be reported, included, or otherwise reflected by the specified person on an annual return. A specified person has an interest in a specified foreign financial asset even if no income, gains, losses, deductions, credits, gross proceeds, or distributions are attributable to the holding or disposition of the specified foreign financial asset for the taxable year.

(2) *Special rule for parent making election under section 1(g)(7)*. A parent that makes an election under section 1(g)(7) to include certain unearned income of a child in the parent's gross income has an interest in any specified foreign financial asset held by the child for the purposes of section 6038D and the regulations.

(3) *Entities*. Except as provided in this paragraph, a specified person is not treated as having an interest in any specified foreign financial assets held by a corporation, partnership, trust, or estate solely as a result of the specified person's status as a shareholder, partner, or beneficiary of such entity. A specified person that is treated as the owner of a trust or any portion of a trust under sections 671 through 679, other than a domestic liquidating trust under §301.7701–4(d) of this chapter created pursuant to a court order issued in a bankruptcy under Chapter 7 (11 U.S.C. 701 *et seq.*) or a confirmed plan under Chapter 11 (11 U.S.C. 1101 *et seq.*) of the Bankruptcy Code, or a domestic widely held fixed investment trust under §1.671–5, is treated as having an interest in any specified foreign financial assets held by the trust or the portion of the trust. See §1.6038D–3T(c) to determine whether an interest in a foreign trust or an interest in a foreign estate is a specified foreign financial asset. See §1.6038D–5T(f) for rules to determine the maximum value of an interest in a foreign trust or estate.

(c) *Special rules for joint interests*—(1) *Aggregate value of assets*—(i) *Specified persons*. Except in the case of a specified person described in paragraph (c)(1)(ii) of this section, each specified person that is a joint owner of a specified foreign financial asset must include the entire value of the specified foreign financial asset (and not the value of the specified person's interest) for purposes of determining whether the aggregate value of the specified person's specified foreign financial assets exceeds the reporting thresholds set forth in §1.6038D–2T(a).

(ii) *Married specified individuals*. Married specified individuals who file a joint annual return must include the value of a specified foreign financial asset that they jointly own or in which they have an interest under paragraph (b)(2) of this section only once in determining whether the aggregate value of all of the specified foreign financial assets in which either married specified individual has an interest exceeds the reporting thresholds set forth in §1.6038D–2T(a). If a married specified individual files a separate annual return and his or her spouse is a specified individual, the married specified individual includes one-half of the value of a specified foreign financial asset that the married specified individual jointly owns with his or her spouse in determining whether the married specified individual has an interest in specified foreign financial assets the aggregate value of which exceeds the reporting thresholds set forth in §1.6038D–2T(a).

(2) *Annual return filed by a married specified individual*—(i) *Joint annual return*. Married specified individuals that file a joint annual return must file a single Form 8938 to fulfill their reporting requirements under section 6038D and §1.6038D–2T(a). The single Form 8938 must report all of the specified foreign financial assets in which either married specified individual has an interest. If the married specified individuals jointly own a specified foreign financial asset or if they have an interest in a specified foreign financial asset under paragraph (b)(2) of this section, the asset must be reported only once on the single Form 8938 filed for the taxable year.

(ii) *Separate annual return*. A married specified individual who files a separate annual return for the taxable year must fulfill the reporting requirements under section 6038D and §1.6038D–2T(a) by filing a separate Form 8938 that reports all of the specified foreign financial assets in which the married specified individual has an interest, including assets jointly owned with the married specified individual's spouse.

(d) *Example*. The following example illustrates the application of paragraph (c) of this section:

Example. (1) *Facts*. Two married specified individuals, H and W, jointly own a specified foreign financial asset with a value of $90,000 at all times during the taxable year. H separately has an interest in a specified foreign financial asset with a value of $10,000 at all times during the taxable year. W separately has an interest in a specified foreign financial asset with a value of $1,000 at all times during the taxable year.

(2) *Filing requirement*—(i) *Married specified individuals filing a separate annual return*. If H and W file separate annual returns, the aggregate value of the specified foreign financial assets in which H has an interest at the end of the taxable year is $55,000, comprising one-half of the value of the jointly owned asset, $45,000, and the value of H's separately owned specified foreign financial asset, $10,000. The aggregate value of the specified foreign financial assets in which W has an interest at the end of the taxable year is $46,000, comprising one-half of the value of the jointly owned asset, $45,000, and the value of W's separately owned specified foreign financial asset, $1,000. H must file Form 8938 with his annual return for the taxable year because the aggregate value of the specified foreign financial assets in which H has an interest exceeds the applicable reporting threshold ($50,000) set forth in §1.6038D–2T(a)(1). H must report the maximum value of the entire jointly owned asset, $90,000, and the maximum value of the separately owned asset, $10,000. See §1.6038D–5T(b) regarding the maximum value of a jointly owned specified foreign financial asset to be reported by a specified person, including a married specified individual, that is a joint owner of an asset. The aggregate value of the specified foreign financial assets in which W has an interest, $46,000, does not exceed the applicable reporting threshold forth in §1.6038D–2T(a)(1). W is not required to file Form 8938 with her separate annual return.

(ii) *Married specified individuals filing a joint annual return*. If H and W file a joint annual return, they must file a single Form 8938 with their joint annual return for the taxable year because the aggregate value of all of the specified foreign financial assets in which either H and W have an interest ($90,000 (included only once), $10,000, and $1000, or $101,000) exceeds the applicable reporting threshold ($100,000) set forth in §1.6038D–2T(a)(2). The single Form 8938 must report the maximum value of the jointly owned specified foreign financial asset, $90,000, and the maximum value of the specified foreign financial assets separately owned by H and W, $10,000 and $1,000, respectively.

(e) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(f) *Expiration date*. The applicability of this section expires December 12, 2014.

Par. 5. Section 1.6038D–3T is added to read as follows:

§1.6038D–3T Specified foreign financial assets (temporary).

(a) *Financial accounts*—(1) *In general*. Except as otherwise provided in this section, a specified foreign financial asset includes any financial account maintained by a foreign financial institution. An asset held in a financial account maintained by a foreign financial institution is not required to be separately reported on Form 8938, *"Statement of Specified Foreign Financial Assets."*

(2) *Financial account in a U.S. possession*. A specified foreign financial asset includes a financial account maintained by a financial institution that is organized under the laws of a U.S. possession.

(3) *Excepted financial accounts*— (i) *Accounts maintained by U.S. payors*. A financial account maintained by a U.S. payor as defined in §1.6049–5(c)(5)(i) (including assets held in such an account) is not a specified foreign financial asset for purposes of section 6038D and the regulations.

(ii) *Mark-to-market election under section 475*. A financial account is not a specified foreign financial asset if the rules of section 475(a) apply to all of the holdings in the account or an election under section 475(e) or (f) is made with respect to all of the holdings in the account.

(b) *Other specified foreign financial assets*— (1) *In general*. Except as otherwise provided in this section, a specified foreign financial asset includes any of the following assets that are held for investment and not held in an account maintained by a financial institution —

(i) Stock or securities issued by a person other than a United States person;

(ii) A financial instrument or contract that has an issuer or counterparty which is other than a United States person; and

(iii) An interest in a foreign entity.

(2) *Mark-to-market election under section 475*. An asset is not a specified foreign financial asset if the rules of section 475(a) apply to the asset or an election under section 475(e) or (f) is made with respect to the asset.

(3) *Held for investment*. An asset is held for investment for purposes of section 6038D and the regulations if that asset is not used in, or held for use in, the conduct of a trade or business of a specified person.

(4) *Trade-or-business test*. For purposes of section 6038D and the regulations, an asset is used in, or held for use in, the conduct of a trade or business and not held for investment if the asset is—

(i) Held for the principal purpose of promoting the present conduct of a trade or business;

(ii) Acquired and held in the ordinary course of a trade or business, as, for example, in the case of an account or note receivable arising from that trade or business; or

(iii) Otherwise held in a direct relationship to the trade or business as determined under paragraph (b)(5) of this section.

(5) *Direct relationship between holding an asset and a trade or business* — (i) *In general*. In determining whether an asset is held in a direct relationship to the conduct of a trade or business by a specified person, principal consideration will be given to whether the asset is needed in the trade or business of the specified person. An asset shall be considered needed in a trade or business, for this purpose, only if the asset is held to meet the present needs of that trade or business and not its anticipated future needs. An asset shall be considered as needed in the trade or business if, for example, the asset is held to meet the operating expenses of the trade or business. Conversely, an asset shall be considered as not needed in the trade or business if, for example, the asset is held for the purpose of providing for future diversification into a new trade or business, future plant replacement, or future business contingencies. Stock is never considered used or held for use in a trade or business for purposes of applying this test.

(ii) *Presumption of direct relationship*. An asset will be treated as held in a direct relationship to the conduct of a trade or business of a specified person if—

(A) The asset was acquired with funds generated by the trade or business of the specified person or the affiliated group of the specified person, if any;

(B) The income from the asset is retained or reinvested in the trade or business; and

(C) Personnel who are actively involved in the conduct of the trade or business exercise significant management and control over the investment of such asset.

(c) *Special rule for interests in foreign trusts and foreign estates*. An interest in a foreign trust or a foreign estate is not a specified foreign financial asset of a specified person unless the person knows or has reason to know based on readily accessible information of the interest. Receipt of a distribution from the foreign trust or foreign estate constitutes actual knowledge for this purpose.

(d) *Examples*. Examples of assets other than financial accounts that may be considered other specified foreign financial assets include, but are not limited to—

(1) Stock issued by a foreign corporation;

(2) A capital or profits interest in a foreign partnership;

(3) A note, bond, debenture, or other form of indebtedness issued by a foreign person;

(4) An interest in a foreign trust;

(5) An interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement with a foreign counterparty; and,

(6) Any option or other derivative instrument with respect to any of the items listed as examples in this paragraph or with respect to any currency or commodity that is entered into with a foreign counterparty or issuer.

(e) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(f) *Expiration date*. The applicability of this section expires December 12, 2014.

Par. 6. Section 1.6038D–4T is added to read as follows:

§1.6038D–4T Information required to be reported (temporary).

(a) *Required information*. The following information must be reported on Form 8938, *"Statement of Specified Foreign Financial Assets,"* with respect to each specified foreign financial asset:

(1) In the case of a financial account maintained by a foreign financial institution, the name and address of the foreign financial institution and the account number of the account;

(2) In the case of stock or a security, the name and address of the issuer, and information that identifies the class or issue of which the stock or security is a part;

(3) In the case of a financial instrument or contract, information that identifies the financial instrument or contract, including the names and addresses of all issuers and counterparties;

(4) In the case of an interest in a foreign entity, information that identifies the interest, including the name and address of the entity;

(5) The maximum value of the specified foreign financial asset during the portion of the taxable year in which the specified person has an interest in the asset;

(6) In the case of a financial account that is a depository or custodial account under section 1471(d)(2), whether the account was opened or closed during the taxable year;

(7) The date, if any, on which the specified foreign financial asset, other than a financial account that is a depository or custodial account under section 1471(d)(2), was either acquired or disposed of (or both) during the taxable year;

(8) The amount of any income, gain, loss, deduction, or credit recognized for the taxable year with respect to the reported specified foreign financial asset, and the schedule, form, or return filed with the Internal Revenue Service on which the income, gain, loss, deduction, or credit, if any, is reported or included by the specified person;

(9) The foreign currency exchange rate and, if the source of such rate is other than as described in §1.6038D–5T(c)(1), the source of the rate used to determine the specified foreign financial asset's U.S. dollar value, including maximum value; and

(10) For any specified foreign financial asset excepted from reporting on Form 8938 under §1.6038D–7T(a), the specified person must report the number of Forms 3520, *"Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts,"* Forms 3520–A, *"Annual Information Return of Foreign Trust With a U.S. Owner,"* Forms 5471, *"Information Return of U.S. Persons With Respect To Certain Foreign Corporations,"* Forms 8621, *"Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund,"* Forms 8865, *"Return of U.S. Persons With Respect to Certain Foreign Partnerships,"* Forms 8891, *"U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans,"* or such other form under Title 26 of the United States Code identified by the Secretary under §1.6038D–7T(a), timely filed with the Internal Revenue Service on which excepted foreign financial assets are reported or reflected for the taxable year.

(b) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(c) *Expiration date*. The applicability of this section expires December 12, 2014.

Par. 7. Section 1.6038D–5T is added to read as follows:

§1.6038D–5T Valuation guidelines (temporary).

(a) *Fair market value*. Except as provided in paragraphs (c) and (e) of this section, the value of a specified foreign financial asset for purposes of determining the aggregate value of specified foreign financial assets held by a specified person and the maximum value of a specified foreign financial asset required to be reported on Form 8938, *"Statement of Specified Foreign Financial Assets,"* is the asset's fair market value.

(b) *Valuation of assets*—(1) *Maximum Value*. Except as provided in this section, the maximum value of a specified foreign financial asset means a reasonable estimate of the asset's maximum fair market value during the taxable year.

(2) *U.S. dollars*. For purpose of determining the aggregate value of specified foreign financial assets in which a specified person has an interest and determining the maximum value of a specified foreign financial asset, the value of a specified foreign financial asset denominated in a foreign currency during the taxable year must be determined in the foreign currency and then converted to U.S. dollars.

(3) *Asset with no positive value*. If the maximum fair market value of a specified foreign financial asset is less than zero, its value is treated as zero for purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest and determining the maximum value of the specified foreign financial asset,

(c) *Foreign currency conversion*—(1) *In general*. Except as provided in paragraph (c)(2) of this section, the U.S. Treasury Department's Financial Management Service foreign currency exchange rate is to be used to convert the value of a specified foreign financial asset into U.S. dollars for purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest and determining the maximum value of a specified foreign financial asset,

(2) *Other publicly available exchange rate*. If no U.S. Treasury Financial Management Service foreign currency exchange rate is available for a particular currency, another publicly available foreign currency exchange rate may be used to convert the value of a specified foreign financial asset into U.S. dollars. In such case, the source of the foreign currency exchange rate must be disclosed on Form 8938.

(3) *Currency exchange rate*. In converting the currency of a foreign country, the foreign currency exchange rate applicable for converting the currency into U.S. dollars (that is, to purchase U.S. dollars) must be used.

(4) *Determination date*. In converting the currency of a foreign country into U.S. dollars for purposes of determining the maximum value of a specified foreign financial asset and determining the aggregate value of specified foreign financial assets in which a specified person has an interest, the applicable foreign currency exchange rate is the rate on the last day of the taxable year of the specified person, even if the specified person sold or otherwise disposed of a specified foreign financial asset prior to the last day of such year.

(d) *Financial accounts*. A specified person may rely upon periodic account statements provided at least annually to determine a financial account's maximum value unless the specified person has actual knowledge or reason to know based on readily accessible information that the statements do not reflect a reasonable estimate of the maximum account value during the taxable year.

(e) *Asset held in a financial account*. The value of an asset held in a financial account maintained by a foreign financial institution is included in determining the value of that financial account for purposes of §1.6038D–5T(a).

(f) *Other specified foreign financial assets*—(1) *General rule*. Except as provided in paragraphs (f)(2) and (f)(3) of this section, for specified foreign financial assets that are not held in a financial account maintained by a foreign financial institution, a specified person may use the value of the asset as of the last day of the taxable year on which the specified person has an interest in the asset as the maximum value of that asset, unless the specified person has actual knowledge or reason to know based on readily accessible information that the value does not reflect a reasonable estimate of the maximum value of the asset.

(2) *Interests in trusts that are specified foreign financial assets*.

(i) *Maximum value*. If a specified person is a beneficiary of a foreign trust, the maximum value of the specified person's interest in the trust is the sum of —

(A) the fair market value, determined as of the last day of the taxable year, of all of the currency or other property distributed from the foreign trust during the taxable year to the specified person as a beneficiary; and

(B) the value as of the last day of the taxable year of the specified person's right as a beneficiary to receive mandatory distributions from the foreign trust as determined under section 7520.

(ii) *Reporting threshold*. For purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest, if the specified person does not know or have reason to know based on readily accessible information the fair market value of the person's interest in a foreign trust during the taxable year, the value to be included in determining the aggregate value of the specified foreign financial assets is the maximum value of the specified person's interest in the foreign trust under paragraph (f)(2)(i) of this section.

(3) *Interests in estates, pension plans, and deferred compensation plans*.

(i) *Maximum value*. The maximum value of a specified person's interest in a foreign estate, foreign pension plan, or a foreign deferred compensation plan is the fair market value, determined as of the last day of the taxable year, of the specified person's beneficial interest in the assets of the foreign estate, foreign pension plan, or foreign deferred compensation plan. If the specified person does not know or have reason to know based on readily accessible information such fair market value, the maximum value to be reported is the fair market value, determined as of the last day of the taxable year, of the currency and other property distributed during the taxable year to the specified person as a beneficiary or participant.

(ii) *Reporting threshold*. For purposes of determining the aggregate value of specified foreign financial assets in which a specified person has an interest, if the specified person does not know or have reason to know based on readily accessible information the fair market value of the person's interest in a foreign estate, foreign pension plan, or foreign deferred compensation plan during the taxable year, the value to be included in determining the aggregate value of the specified foreign financial assets is the fair market value, determined as of the last day of the taxable year, of the currency and other property distributed during the taxable year to the specified person as a beneficiary or participant.

(g) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(h) *Expiration date*. The applicability of this section expires December 12, 2014.

Par. 8. Section 1.6038D–6T is added to read as follows:

§1.6038D–6T Specified domestic entities (temporary). [Reserved]

Par. 9. Section 1.6038D–7T is added to read as follows:

§1.6038D–7T Exceptions from the reporting of certain assets under Section 6038D (temporary).

(a) *Elimination of duplicative reporting of assets*—(1) *In general*. A specified person is not required to report a specified foreign financial asset on Form 8938, *"Statement of Specified Foreign Financial Assets,"* if the specified person—

(i) Reports the asset on at least one of the following forms timely filed with the Internal Revenue Service for the taxable year—

(A) Form 3520, *"Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"* (in the case of a specified person who is the beneficiary of a foreign trust);

(B) Form 5471, *"Information Return of U.S. Persons With Respect To Certain Foreign Corporations"*;

(C) Form 8621, *"Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund"*;

(D) Form 8865, *"Return of U.S. Persons With Respect to Certain Foreign Partnerships"*; or

(E) Form 8891, *"U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans"*; or

(F) Any other form under Title 26 of the United States Code timely filed with the Internal Revenue Service and identified for this purpose by the Secretary in regulations or other guidance; and

(ii) Reports on Form 8938 the filing of the form on which the asset is reported.

(2) *Foreign grantor trusts*. A specified person that is treated as an owner of a foreign trust or any portion of a foreign trust under sections 671 through 679 is not required to report any specified foreign financial assets held by the foreign trust on Form 8938, provided—

(i) The specified person reports the trust on a Form 3520 timely filed with the Internal Revenue Service for the taxable year;

(ii) The trust timely files Form 3520–A, *"Annual Information Return of Foreign Trust With a U.S. Owner,"* with the Internal Revenue Service for the taxable year; and

(iii) The Form 8938 filed by the specified person for the taxable year reports the filing of the Form 3520 and Form 3520–A.

(b) *Owner of certain trusts*. A specified person that is treated as an owner of any portion of a domestic trust under sections 671 through 678 is not required to file Form 8938 to report any specified foreign financial asset held by the trust if the trust is—

(1) A widely-held fixed investment trust under §1.671–5; or

(2) A liquidating trust within the meaning of §301.7701–4(d) of this chapter that is created pursuant to a court order issued in a bankruptcy under Chapter 7 (11 U.S.C. 701 *et seq.*) or a confirmed plan under Chapter 11 (11 U.S.C. 1101 *et seq.*) of the Bankruptcy Code.

(c) *Bona fide resident of a U.S. possession*. A specified individual who is a *bona fide* resident of a U.S. possession and who is required to file Form 8938 with the Internal Revenue Service is not required to report the following specified foreign financial assets:

(1) A financial account maintained by a financial institution organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident;

(2) A financial account maintained by a branch of a financial institution not organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident, if the branch is subject to the same tax and information reporting requirements applicable to a financial institution organized under the laws of the U.S. possession;

(3) Stock or securities issued by an entity organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident;

(4) An interest in an entity organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident; and

(5) A financial instrument or contract held for investment, provided each issuer or counterparty that is not a United States person is —

(i) An entity organized under the laws of the U.S. possession of which the specified individual is a *bona fide* resident; or

(ii) A *bona fide* resident of the U.S. possession of which the specified individual is a *bona fide* resident.

(d) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(e) *Expiration date*. The applicability of this section expires December 12, 2014.

Par. 10. Section 1.6038D–8T is added to read as follows:

§1.6038D–8T Penalties for failure to disclose (temporary).

(a) *In general.* If a specified person fails to file a Form 8938, *"Statement of Specified Foreign Financial Assets,"* that includes the information required by section 6038D(c) and §1.6038D–4T with respect to any taxable year at the time and in the manner described in section 6038D(a) and §1.6038D–2T, a penalty of $10,000 will apply to that specified person.

(b) *Married specified individuals filing a joint annual return*. Married specified individuals who file a joint annual return and fail to file a required Form 8938, *"Statement of Specified Foreign Financial Assets,"* that includes the information required by section 6038D(c) and §1.6038D–4T with respect to any taxable year at the time and in the manner described in section 6038D(a) and §1.6038D–2T are subject to penalties under this section as if the married specified individuals are a single specified person. The liability of married specified individuals who file a joint annual return with respect to any penalties under this section is joint and several.

(c) *Increase in penalty.* If any failure to comply with the applicable reporting requirement of section 6038D and the regulations continues for more than 90 days after the day on which the Commissioner or his delegate mails a notice of the failure to the specified person required to file the Form 8938, the specified person is required to pay an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure continues after the 90-day period has expired. The additional penalty imposed by section 6038D(d)(2) and this paragraph (c) is limited to a maximum of $50,000 for each such failure.

(d) *Presumption of aggregate value*. For the purpose of assessing penalties imposed under section 6038D(d), if the Commissioner or his delegate determines that a specified person has an interest in one or more specified foreign financial assets and the specified person does not provide sufficient information to demonstrate the aggregate value of the assets upon request by the Commissioner or his delegate, then the aggregate value of the assets is treated as being in excess of the applicable reporting threshold set forth in §1.6038D–2T(a).

(e) *Reasonable cause exception*—(1) *In general*. If the failure to report the information required in section 6038D(c) and §1.6038D–4T is shown to be due to reasonable cause and not due to willful neglect, no penalty will be imposed under section 6038D(d) or this section.

(2) *Affirmative showing required*. In order to show that the failure to disclose is due to reasonable cause and not due to willful neglect for purposes of section 6038D(g) and this section, the specified person must make an affirmative showing of all the facts alleged as reasonable cause for the failure to disclose.

(3) *Facts and circumstances taken into account*. The determination of whether a failure to disclose a specified foreign financial asset on Form 8938 was due to reasonable cause and not due to willful neglect is made on a case-by-case basis, taking into account all pertinent facts and circumstances. The fact that a foreign jurisdiction would impose a civil or criminal penalty on the specified person (or any other person) for disclosing the required information is not reasonable cause.

(f) *Penalties for underpayments attributable to undisclosed foreign financial assets*—(1) *Accuracy-related penalty*. For application of the accuracy-related penalty in the case of any portion of an underpayment attributable to any undisclosed foreign financial asset understatement, see section 6662(j).

(2) *Criminal penalties*. In addition to other penalties, failure to comply with the reporting requirements of section 6038D and the regulations, or any underpayment related to such failure, may result in criminal penalties under sections 7201, 7203, 7206, *et seq*., or other provisions of Federal law.

(g) *Effective/applicability dates*. This section applies to taxable years ending after December 19, 2011. Taxpayers may elect to apply the rules of this section to taxable years ending prior to December 19, 2011.

(h) *Expiration date*. The applicability of this section expires December 12, 2014.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved November 30, 2011.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on December 14, 2011, 4:15 p.m., and published in the issue of the Federal Register for December 19, 2011, 76 F.R. 78553)

Part III. Administrative, Procedural, and Miscellaneous

Health Savings Accounts

Notice 2012–14

PURPOSE

This notice provides guidance on whether an individual eligible to receive medical services at an Indian Health Service facility is an "eligible individual" with respect to Health Savings Accounts (HSAs) under § 223 of the Internal Revenue Code (the Code).

BACKGROUND

Section 1201 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108–173, added § 223 of the Code to permit eligible individuals to establish HSAs for taxable years beginning after December 31, 2003. The Health Opportunity Patient Empowerment Act of 2006, Pub. L. No. 109–432 (HOPE Act), amended § 223 of the Code effective generally for taxable years after December 31, 2006.

Section 223(c)(1) provides that an eligible individual means, for any month, an individual who is covered by a high deductible health plan (HDHP) on the first day of such month and, generally, is not covered by any other health plan, with certain exceptions. In addition, an eligible individual cannot be claimed as a tax dependent on another person's tax return and cannot be enrolled in Medicare. Section 223(b)(6) and (7). An eligible individual may establish and make tax-free contributions to an HSA. Notice 2004–2, 2004–1 C.B. 269, Notice 2004–50, 2004–2 C.B. 196, and Notice 2008–59, 2008–2 C.B. 123, provide guidance on HSAs.

Indian Health Service (IHS) is a Division within the U.S. Department of Health and Human Services. An "IHS facility" means a facility operated directly by IHS, or by a tribe or tribal organization under the Indian Self-Determination and Education Assistance Act. Eligibility for IHS services is determined under 42 CFR 136.12.

HSA ELIGIBILITY RULES AND IHS FACILITIES

An individual who is eligible to receive medical services at an IHS facility, but who has not actually received such services during the previous three months, is an eligible individual within the meaning of § 223(c)(1) who may establish and make tax-free contributions to an HSA. However, an individual generally is not an eligible individual if the individual has received medical services at an IHS facility at any time during the previous three months. Notice 2004–2, Q&A–6, provides that the receipt of permitted coverage, such as dental and vision care, or the receipt of preventive care, such as well-baby visits, immunizations, weight-loss and tobacco cessation programs, does not affect an individual's eligibility.

REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on the eligibility rule described in this notice. Comments must be submitted by April 30, 2012. All materials submitted will be available for public inspection and copying. Comments should be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2012–14), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20224. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:RU (Notice 2012–14), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2012–14) in the subject line.

DRAFTING INFORMATION

The principal author of this notice is Leslie Paul of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) though other Treasury Department and IRS officials participated in its development. For further information on the submission of comments or the comments submitted, contact (202) 622–7180 (not a toll-free number). For further information on all other provisions of this notice, contact Leslie Paul at (202) 622–6080 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Reporting of Specified Foreign Financial Assets

REG–130302–10

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY:
In this issue of the Bulletin, the Internal Revenue Service is issuing temporary regulations (T.D. 9567) relating to the requirement that individuals attach a statement to their income tax return to provide required information regarding foreign financial assets in which they have an interest. The text of the temporary regulations also serves as the text of these proposed regulations. This notice of proposed rulemaking also includes a proposed regulation setting forth requirements for certain domestic entities to report foreign financial assets in the same manner as an individual.

DATE: Written or electronic comments and requests for a public hearing must be received by March 19, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–130302–10), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–130302–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–130302–10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Joseph S. Henderson, (202) 622–3880; concerning submission of comments and/or requests for a hearing, Olawafunmilayo (Funmi) Taylor, at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:M:S, Washington, DC 20224. Comments on the collection of information should be received by February 13, 2012. Comments are specifically requested concerning:

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

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

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

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

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

The collection of information in these proposed regulations is in §§1.6038D–2 and 1.6038D–4. The collection of information is mandatory with respect to a specified person that has an interest in specified foreign financial assets and the value of those assets is more than the applicable reporting threshold. The respondents are U.S. citizens, U.S. residents, certain nonresidents and, to the extent provided in future regulations, certain domestic entities. The collection of information is satisfied by filing Form 8938, *"Statement of Specified Foreign Financial Assets,"* OMB No. 1545–2195, with the respondent's income tax return.

Estimated total annual reporting burden: 378,000 hours.

Estimated annual burden per respondent: 1 hour and 5 minutes.

Estimated number of respondents: 350,000.

Estimated annual frequency of responses: once.

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

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

Background

Section 6038D was enacted by section 511 of the Hiring Incentives to Restore Employment (HIRE) Act, Public Law 111–147 (124 Stat. 71). Section 6038D(a) requires an individual who holds any interest in a specified foreign financial asset during the taxable year to attach a statement to that individual's return of tax imposed by subtitle A of the Internal Revenue Code (Code) to report the information identified in section 6038D(c), if the aggregate value of the specified foreign financial assets in which the individual holds an interest exceeds $50,000 for the taxable year, or such higher dollar amount as the Secretary may prescribe.

Section 6038D(f) provides that, to the extent provided by the Secretary in regulations or other guidance, section 6038D shall apply to any domestic entity which is formed of availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if the entity were an individual.

Temporary regulations in this issue of the Bulletin contain amendments to the Income Tax Regulations (26 CFR Part 1) providing guidance to individuals required to report specified foreign financial assets with their annual return pursuant to section 6038D of the Code. The text of those regulations also serves as the text of the regulations contained in this document that are proposed by cross-reference to the temporary regulations, that is §§1.6038D–0 through 1.6038D–5, §1.6038D–7, and §1.6038D–8. The preamble to the temporary regulations explains the amendments added by the temporary regulations.

This document also contains a proposed amendment to the Income Tax Regulations (26 CFR Part 1) that sets out the conditions under which a domestic entity will be considered a "specified domestic entity." A domestic entity that is a specified domestic entity pursuant to Prop. Reg. §1.6038D–6 is required to report specified foreign financial assets in which it holds an interest.

Explanation of Provisions

1. *Application of Section 6038D to Domestic Entities*

Under the proposed regulations, domestic entities that are subject to the reporting requirements of section 6038D are designated as specified domestic entities and include certain domestic corporations, domestic partnerships, and trusts described in section 7701(a)(30)(E), generally referred to as domestic trusts for purposes of this explanation. Specified domestic entities do not include domestic estates.

A. *Domestic corporations and partnerships*

For a domestic corporation or partnership to be considered a specified domestic entity, it must satisfy three conditions. First, the domestic corporation or domestic partnership must have an interest in specified foreign financial assets (other than assets excepted from reporting as provided in §1.6038D–7T) with an aggregate value exceeding the reporting threshold in §1.6038D–2T(a)(1). Second, it must be closely held by a specified individual (as defined in §1.6038D–1T(a)(2)). A domestic corporation is closely held if a specified individual owns at least 80 percent of the corporation's stock (by vote or value) on the last day of the corporation's taxable year. A domestic partnership is closely held if a specified individual owns at least 80 percent of the capital or profits interest in the partnership on the last day of its taxable year. Direct, indirect, and constructive ownership rules apply in determining whether the corporation or partnership is closely held for this purpose.

Finally, a domestic corporation or partnership must also meet either of the following two conditions:

(A) At least 50 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 50 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income; or

(B) At least 10 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 10 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income, and the corporation or partnership is formed or availed of by a specified individual with a principal purpose of avoiding the reporting obligations under section 6038D. The determination of whether a corporation or partnership is formed or availed of with a principal purpose of avoiding reporting under section 6038D takes into account all facts and circumstances.

Two different aggregation rules apply for purposes of determining whether a domestic corporation or domestic partnership is a specified domestic entity. First, in determining whether a domestic corporation or domestic partnership meets the reporting thresholds in §1.6038D–2T(a)(1), domestic corporations and domestic partnerships that are closely held by the same specified individual are treated as a single entity. Second, for purposes of determining whether a corporation or partnership meets the passive income or asset test, domestic corporations and domestic partnerships that are closely held by the same individual and that are connected through stock or partnership interest ownership with a common parent corporation or partnership are treated as a single entity.

The determination of whether a corporation or partnership is a specified domestic entity is made annually for each taxable year of such corporation or partnership.

B. *Domestic trusts*

A domestic trust is considered a specified domestic entity if it has an interest in specified foreign financial assets (other than assets excepted from reporting as provided in §1.6038D–7T) with an aggregate value exceeding the reporting threshold in §1.6038D–2T(a)(1) and one or more specified persons as current beneficiaries. For purposes of section 6038D, a current beneficiary is any person who, during the taxable year, is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year). As discussed in section 2 of this explanation, certain domestic trusts are not specified domestic entities.

The determination of whether a domestic trust is a specified domestic entity is made annually for each taxable year of such trust.

2. *Excepted Specified Domestic Entities*

A domestic entity is not considered to be a specified domestic entity if it is described in section 1473(3) and the regulations as excepted from the definition of the term "specified United States person". This exception does not apply to any trust that is exempt from tax under section 664(c).

A domestic trust is not considered a specified domestic entity if the trustee is a bank, financial institution, or domestic corporation that is subject to certain examination, oversight or registration requirements, has supervisory authority over or fiduciary obligations with regard to the trust's specified foreign financial assets, and files income tax returns and information returns on behalf of the trust. In addition, a domestic trust or any portion of the trust that is treated as owned by one or more specified persons under sections 671 through 678 and the regulations issued under those sections is not considered to be a specified domestic entity.

Proposed Effective Date

Section 1.6083D–6 is proposed to apply to taxable years beginning after December 31, 2011.

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 also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collection of information in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Small entities generally hold specified foreign financial assets (that is, financial accounts, stocks, securities, financial instruments, contracts, or interests in foreign entities) for use in their trade or business and therefore generally would not have a filing requirement. The burden is further reduced because small entities that do hold specified foreign financial assets generally will be excepted from reporting such assets under these proposed rules if the assets are reported on one or more of the following forms: Form 3520, *"Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"*; Form 3520–A, *"Annual Information Return of Foreign Trust With a U.S. Owner"*; Form 5471, *"Information Return of U.S. Persons With Respect To Certain Foreign Corporations"*; Form 8621, *"Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund"*; Form 8865, *"Return of U.S. Persons With Respect to Certain Foreign Partnerships"*; or Form 8891, *"U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans."* Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. The Internal Revenue Service invites the public to comment on this certification.

Comments and Requests for 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 comments that are submitted timely to the IRS. The Department of the Treasury and the Internal Revenue Service request comments on all aspects of the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Joseph S. Henderson, Office of Associate Chief Counsel (International). However, other personnel from the Internal Revenue Service and the Department of the Treasury participated in their development.

* * * * *

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

PART 1 — INCOME TAXES

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

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

Section 1.6038D–1 also issued under 26 U.S.C. 6038D

Section 1.6038D–2 also issued under 26 U.S.C. 6038D

Section 1.6038D–3 also issued under 26 U.S.C. 6038D

Section 1.6038D–4 also issued under 26 U.S.C. 6038D

Section 1.6038D–5 also issued under 26 U.S.C. 6038D

Section 1.6038D–6 also issued under 26 U.S.C. 6038D

Section 1.6038D–7 also issued under 26 U.S.C. 6038D

Section 1.6038D–8 also issued under 26 U.S.C. 6038D* * *

Par. 2. Section 1.6038D–0 is added to read as follows:

§1.6038D–0 Outline of regulation provisions.

The text of proposed §1.6038D–0 is the same as the text of §1.6038D–0T published elsewhere in this issue of the Bulletin.

Par. 3. Section 1.6038D–1 is added to read as follows:

§1.6038D–1 Reporting with respect to specified foreign financial assets, definition of terms.

The text of proposed §1.6038D–1 is the same as the text of paragraphs (a) and (b) in §1.6038D–1T published elsewhere in this issue of the Bulletin.

Par. 4 Section 1.6038D–2 is added to read as follows:

§1.6038D–2 Requirement to report specified foreign financial assets.

The text of proposed §1.6038D–2 is the same as the text of paragraphs (a) through (e) in §1.6038D–2T published elsewhere in this issue of the Bulletin.

Par. 5 Section 1.6038D–3 is added to read as follows:

§1.6038D–3 Specified foreign financial assets.

The text of proposed §1.6038D–3 is the same as the text of paragraphs (a) through (e) in §1.6038D–3T published elsewhere in this issue of the Bulletin.

Par. 6. Section 1.6038D–4 is added to read as follows:

§1.6038D–4 Information required to be reported.

The text of proposed §1.6038D–4 is the same as the text of paragraphs (a) and (b) in §1.6038D–4T published elsewhere in this issue of the Bulletin.

Par. 7. Section 1.6038D–5 is added to read as follows:

§1.6038D–5 Valuation guidelines.

The text of proposed §1.6038D–5 is the same as the text of paragrahs (a) through (g) in §1.6038D–5T published elsewhere in this issue of the Bulletin.

Par. 8. Section 1.6038D–6 is added to read as follows:

§1.6038D–6 Specified domestic entities.

(a) *Specified domestic entity*. A specified domestic entity is a domestic corporation, a domestic partnership, or a trust described in section 7701(a)(30)(E), if such corporation, partnership, or trust is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets. Whether a domestic corporation, a domestic partnership, or a trust described in section 7701(a)(30)(E) is a specified domestic entity is determined annually.

(b) *Corporations and partnerships*—(1) *Formed or availed of*. Except as otherwise provided in paragraph (d) of this section, a domestic corporation or a domestic partnership is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if—

(i) The corporation or partnership has an interest in specified foreign financial assets (other than assets excepted from reporting as provided in §1.6038D–7T) with an aggregate value exceeding the reporting threshold in §1.6038D–2T(a)(1);

(ii) The corporation or partnership is closely held by a specified individual as determined under paragraph (b)(3) of this section; and

(iii) One of the following two conditions is satisfied:

(A) At least 50 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 50 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income; or

(B)(*1*) At least 10 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 10 percent of the assets held by the corporation or partnership at any time during the taxable year are assets that produce or are held for the production of passive income, and

(*2*) The corporation or partnership is formed or availed of by the specified individual identified in paragraphs (b)(1)(ii) and (b)(3) of this section with a principal purpose of avoiding the reporting obligations under section 6038D. For purposes of determining whether a corporation or partnership is formed or availed of with a principal purpose of avoiding reporting under section 6038D, all facts and circumstances are taken into account.

(2) *Passive income*. For purposes of paragraph (b) of this section, passive income means the portion of gross income that consists of—

(i) Dividends;

(ii) Interest;

(iii) Rents and royalties, other than rents and royalties derived in the active conduct of a trade or business conducted by employees of the corporation or partnership;

(iv) Annuities;

(v) The excess of gains over losses from the sale or exchange of property that gives rise to passive income described in paragraphs (b)(2)(i), (b)(2)(ii), (b)(2)(iii), and (b)(2)(iv) of this section;

(vi) The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodity, but not including any commodity hedging transaction described in section 954(c)(5)(A) determined by treating the corporation or partnership as a controlled foreign corporation;

(vii) The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transaction; and

(viii) Net income from notional principal contracts.

(3) *Closely held*—(i) *Domestic corporation*. A domestic corporation is closely held by a specified individual for purposes of paragraph (b)(1)(ii) of this section if at least 80 percent of the total combined voting power of all classes of stock of the corporation entitled to vote, or at least 80 percent of the total value of the stock of the corporation, is owned, directly, indirectly, or constructively, by one specified individual on the last day of the corporation's taxable year.

(ii) *Domestic partnership*. A partnership is closely held by a specified individual for purposes of paragraph (b)(1)(ii) of this section if at least 80 percent of the capital or profits interest in the partnership is held, directly, indirectly, or constructively, by one specified individual on the last day of the partnership's taxable year.

(iii) *Constructive ownership*. For purposes of paragraphs (b)(1)(ii) and (b)(3) of this section, section 267(c) and (e)(3) apply for the purpose of determining the interest of a specified individual in a corporation or partnership, except that section 267(c)(4) is applied as if the family of an individual includes the spouses of the individual's family members.

(iv) *Example*. The following example illustrates the application of paragraph (b)(3) of this section:

Example. (1) *Facts*. DC1 is a domestic corporation the total value of the stock of which is owned 60% by A, a specified individual, 30% by B, a member of A's family for purposes of section 267(c)(2) who is not a specified individual, and 10% by FC1, a foreign corporation. DC1 owns 90% of the total value of the stock of DC2, a domestic corporation. FC2, a foreign corporation, owns 10% of DC2. Neither A nor B owns, directly, indirectly, or constructively, any stock in FC1 or FC2.

(2) *Ownership determination*. DC2 is closely held by A within the meaning of paragraphs (b)(1)(ii) and (b)(3) of this section because A, a specified person, owns more than 80% of its total value. A is considered to own 81% of the total value of DC2 by application of the rules of section 267(c) and this section.

(4) *Treatment of related corporations and partnerships*—(i) *Determination of reporting threshold*. For purposes of applying paragraph (b)(1)(i) of this section and determining whether a domestic corporation or domestic partnership satisfies the reporting threshold in §1.6038D–2T(a)(1), all domestic corporations and domestic partnerships that have an interest in any specified foreign financial asset and are closely held by the same specified individual as determined under paragraphs (b)(1)(ii) and (b)(3) of this section are treated as a single entity, and each such related corporation or partnership will be treated as owning the specified foreign financial assets held by all such related corporations or partnerships.

(ii) *Determination of passive income and asset thresholds*. For purposes of applying the passive income and asset thresholds of paragraph (b)(1)(iii) of this section, all domestic corporations and domestic partnerships that are closely held by the same specified individual as determined under paragraphs (b)(1)(ii) and (b)(3) of this section and that are connected through stock or partnership interest ownership with a common parent corporation or partnership (as determined under this paragraph (b)(4)(ii)) are treated as a single entity. A domestic corporation or a domestic partnership is considered connected through stock or partnership interest ownership with a common parent corporation or partnership if stock representing at least 80 percent of the voting power or value of each such corporation, or partnership interests representing at least 80 percent of the profits interests or capital interests of the partnership, in each case other than stock of or partnership interests in the common parent, is owned by one or more of the other connected corporations, connected partnerships, or the common parent. For purposes of applying paragraph (b)(1)(iii) of this section, each member of a closely held and connected group as determined under this paragraph (b)(4)(ii) is treated as owning the combined assets and receiving the combined income of all members of that group. For purposes of the preceding sentence, any contract, equity, or debt existing between members of such a group, as well as any items arising under or from such contract, equity, or debt relevant to the determination of the passive income percentage under paragraph (b) of this section, are eliminated.

(5) *Examples*. The following examples illustrate the application of the rules of paragraph (b) of this section:

Example 1. (1) *Facts*. L is a specified individual. In Year X, L wholly owns DC1, a domestic corporation, and also owns a 90% capital interest in DP, a domestic partnership. DC1 owns 80% of the sole class of stock of DC2, a domestic corporation. DC1 has no assets other than its interest in DC2. DC2's only assets are assets that produce passive income, with a maximum value in Year X of $40,000 on October 12. DC2's assets are comprised in relevant part on October 12, Year X, of $15,000 of specified foreign financial assets. DP's only assets are assets that produce passive income and that are specified foreign financial assets with a maximum value of $90,000 on October 12, Year X and have a value of $20,000 on December 31, Year X. DC1 and DC2 do not file a consolidated annual return.

(2) *Determination of reporting threshold*. DC1, DC2, and DP are closely held by L for purposes of applying paragraph (b)(1)(ii) and (b)(3) of this section. Under §1.6038D–3T, DC2 and DP each has an interest in specified foreign financial assets; DC1 does not have an interest in specified foreign financial assets. For purposes of applying paragraph (b)(1)(i) of this section and §1.6038D–2T(a)(1)—

(i) *DC1*. DC1 is not treated as a single entity with DC2 and DP under paragraph (b)(4)(i) of this section. As a result, DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section; and

(ii) *DC2 and DP*. DC2 and DP are treated as a single entity under paragraph (b)(4)(i) of this section. Therefore, for purposes of applying the reporting threshold of §1.6038D–2T(a)(1), DC2 is considered as owning in addition to its own assets the assets of DP, and DP is considered as owning in addition to its own assets the assets of DC2. As a result, DC2 and DP each satisfies the reporting threshold of §1.6038D–2T(a)(1), because the value of the specified foreign financial assets each is considered as owning under paragraph (b)(4)(i) of this section exceeds $100,000 on October 12, Year X.

(3) *Determination of passive income or passive asset percentage*—(i) *DC1 and DC2*. DC1 and DC2 are treated as members of a closely held and connected group of entities under paragraph (b)(4)(ii) of this section, because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 though DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, DC1 and DC2 are considered a single entity for purposes of applying paragraph (b)(1)(iii) of this paragraph, and each of DC1 and DC2 is considered as owning the combined assets, and receiving the combined income, of both DC1 and DC2 (under paragraph (b)(4)(ii) of this section). Therefore, DC1 and DC2 each satisfies the passive asset threshold of paragraph (b)(1)(iii)(A) of this section.

(ii) *DP*. DP is not treated as a member of the DC1 and DC2 closely held and connected group of entities because DC1 and DP are not owned by a common parent corporation or partnership. Therefore, whether the passive income or passive asset threshold of paragraph (b)(1)(iii) of this section is met with respect to DP is determined solely by reference to DP's separately earned passive income and separately held passive assets. DP has only passive assets on October 12, Year X, and, therefore, satisfies paragraph (b)(1)(iii)(A) of this section.

(4) *Reporting requirements*—(i) *DC1*. DC1 is not a specified domestic entity for Year X, and is not required to file Form 8938, because DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section and §1.6038D–2T(a)(1).

(ii) *DC2 and DP*. DC2 and DP are specified domestic entities for Year X, because they each meet the conditions of paragraph (b)(1) of this section: each is closely held by L, a specified individual; each has an interest in specified foreign financial assets with an aggregate value exceeding the reporting threshold of §1.6038D–2T(a)(1); and each satisfies the passive asset threshold. DC2 and DP must each file Form 8938 for Year X to report their respective specified foreign financial assets and disclose their maximum values as provided in §1.6038D–4T.

Example 2. (1) *Facts*. The facts are the same as in Example 1, except that DC2 also has assets and income from a trade or business. The income from such business is not passive income and constitutes 60% of the gross income generated by DC2 in Year X. The assets attributable to such trade or business constitute at least 60% of the value of DC2's assets at all times during Year X. Assume that neither DC1 nor DC2 is formed or availed of by L with a principal purpose of avoiding the reporting obligations under section 6038D.

(2) *Determination of reporting threshold*. DC1, DC2, and DP are closely held by L for purposes of applying paragraph (b)(1)(ii) and (b)(3) of this section. Under §1.6038D–3T, DC2 and DP each has an interest in specified foreign financial assets; DC1 does not have an interest in specified foreign financial assets. For purposes of applying paragraph (b)(1)(i) of this section and §1.6038D–2T(a)(1)—

(i) *DC1*. DC1 is not treated as a single entity with DC2 and DP under paragraph (b)(4)(i) of this section. As a result, DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section; and

(ii) *DC2 and DP*. DC2 and DP are treated as a single entity under paragraph (b)(4)(i) of this section. Therefore, for purposes of applying the reporting threshold of §1.6038D–2T(a)(1), DC2 is considered as owning in addition to its own assets the assets of DP, and DP is considered as owning in addition to its own assets the assets of DC2. As a result, DC2 and DP each satisfies the reporting threshold of §1.6038D–2T(a)(1) because the value of the specified foreign financial assets each is considered as owning under paragraph (b)(4)(i) of this section exceeds $100,000 on October 12, Year X.

(3) *Determination of passive income or passive asset percentage*—(i) *DC1 and DC2*. DC1 and DC2 are treated as members of a closely held and connected group of entities under paragraph (b)(4)(ii) of this section, because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 though DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, DC1 and DC2 are considered a single entity for purposes of applying paragraph (b)(1)(iii) of this paragraph, and each of DC1 and DC2 is considered as owning the combined assets, and receiving the combined income, of both DC1 and DC2 (as determined under paragraph (b)(4)(ii) of this section). DC1 and DC2 do not have sufficient passive income or passive assets to satisfy the thresholds of paragraph (b)(1)(iii)(A) of this section. In addition, because neither DC1 nor DC2 is formed or availed of by L with a principal purpose of avoiding the reporting obligations under section 6038D, neither DC1 nor DC2 meets the conditions described in paragraph (b)(1)(iii)(B) of this section.

(ii) *DP*. DP is not treated as a member of the DC1 and DC2 closely held and connected group of entities, because DC1 and DP are not owned by a common parent corporation or partnership. Therefore, whether the passive income or asset threshold of paragraph (b)(1)(iii) of this section is met with respect to DP is determined solely by reference to DP's separately earned passive income and separately held passive assets. DP has only passive assets that are specified foreign financial assets on October 12, Year X, and satisfies paragraph (b)(1)(iii)(A) of this section.

(4) *Reporting requirements*—(i) *DC1*. DC1 is not a specified domestic entity for Year X, and is not required to file Form 8938, because DC1 does not satisfy the reporting threshold of paragraph (b)(1)(i) of this section and §1.6038D–2T(a)(1).

(ii) *DC2*. DC2 is not a specified domestic entity for Year X, and is not required to file Form 8938, because DC2 does not satisfy the passive income or passive asset threshold of paragraph (b)(1)(iii)(A) of this section and is not formed or availed of with a principal purpose of avoiding the reporting obligations under section 6038D.

(iii) *DP*. DP is a specified domestic entity for Year X because DP meets the conditions of paragraph (b)(1) of this section: DP is closely held by L, a specified individual; DP has an interest in specified foreign financial assets with an aggregate value exceeding the reporting threshold of §1.6038D–2T(a)(1); and DP satisfies the passive asset threshold of paragraph (b)(1)(iii)(A) of this section. DP must file Form 8938 for Year X to report its specified foreign financial assets and disclose their maximum value as provided in §1.6038D–4T.

(c) *Domestic trusts*. Except as provided in paragraph (d) of this section, a trust described in section 7701(a)(30)(E) is a specified domestic entity that is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if the trust—

(1) Has an interest in specified foreign financial assets (other than assets excepted from reporting as provided in §1.6038D–7T) with an aggregate value exceeding the reporting threshold in §1.6038D–2T(a)(1), and

(2) Has one or more specified persons as a current beneficiary. For purposes of this paragraph(c)(2), the term current beneficiary means, with respect to the taxable year, any person who at any time during such taxable year is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year).

(d) *Excepted domestic entities*. An entity is not considered to be a specified domestic entity if the entity is—

(1) *Certain persons described in section 1473(3)*. An entity, except for a trust that is exempt from tax under section 664(c), that is excepted from the definition of the term "specified United States person" under section 1473(3) and the regulations issued under that section;

(2) *Certain domestic trusts*. A trust described in section 7701(a)(30)(E) provided that the trustee of the trust—

(i) Has supervisory authority over or fiduciary obligations with regard to the specified foreign financial assets held by the trust;

(ii) Timely files (including any applicable extensions) annual returns and information returns on behalf of the trust; and

(iii) Is —

(A) A bank that is examined by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or the National Credit Union Association;

(B) A financial institution that is registered with and regulated or examined by the Securities and Exchange Commission; or

(C) A domestic corporation described in section 1473(3)(A) or (B), and the regulations issued under that section.

(3) *Domestic trusts owned by one or more specified persons*. A trust described in section 7701(a)(30)(E) to the extent such trust or any portion thereof is treated as owned by one or more specified persons under sections 671 through 678 and the regulations issued under those sections.

(e) *Effective/applicability dates*. This section applies to taxable years beginning after December 31, 2011.

Par. 9. Section 1.6038D–7 is added to read as follows:

§1.6038D–7 Exceptions from the reporting of certain assets under Section 6038D.

The text of proposed §1.6038D–7 is the same as the text of paragraphs (a) through (d) in §1.6038D–7T published elsewhere in this issue of the Bulletin.

Par. 10. Section 1.6038D–8 is added to read as follows:

§1.6038D–8 Penalties for failure to disclose.

The text of proposed §1.6038D–8 is the same as the text of paragraphs (a) through (g) in §1.6038D–8T published elsewhere in this issue of the Bulletin.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on December 14, 2011, 4:15 p.m., and published in the issue of the Federal Register for December 19, 2011, 76 F.R. 78594)

Notice of Proposed Rulemaking

Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest

REG–124627–11

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations concerning the continuity of interest requirement for corporate reorganizations. The guidance is necessary to clarify the manner in which the continuity of interest requirement is measured in particular circumstances. The proposed regulations affect corporations and their shareholders.

DATES: Written or electronic comments and requests for a public hearing must be received by March 19, 2012.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–124627–11), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–124627–11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or electronically, via the Federal e-Rulemaking Portal at *http://www.regulations.gov/* (IRS REG–124627–11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Richard Starke (202) 622–3497, and concerning submission of comments, Oluwafunmilayo Taylor (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This notice of proposed rulemaking accompanies publication of final regulations regarding the continuity of interest requirement (COI) for corporate reorganizations that are published in this issue of the Bulletin (the 2011 regulations). In general, the 2011 regulations provide the circumstances under which the consideration to be exchanged for the proprietary interests in the target corporation is valued on the last business day before the first date there is a binding contract (the signing date rule). The preamble explains that the signing date rule is based on the principle that where a binding contract provides for fixed consideration, the target corporation shareholders can generally be viewed as being subject to the economic fortunes of the issuing corporation as of the last business day before the signing date (the Pre-Signing Date). However, if the contract does not provide for fixed consideration, the signing date value of the issuing corporation stock is not relevant for purposes of determining the extent to which a proprietary interest in the target corporation is preserved. For additional background regarding the signing date rule, see the preamble to the 2011 regulations published elsewhere in this issue of the Bulletin.

Explanation of Provisions

In response to comments, the IRS and the Treasury Department have reconsidered the scope of the signing date rule, and agree that its underlying principles support additional methods for determining whether COI is satisfied. For example, a contract to effect a potential reorganization may provide that the amount of an item of consideration will vary as the value of issuing corporation stock declines between the stock's Pre-Signing Date value and some lower value provided for in the contract (Floor Price), but will not vary below the Floor Price. If the closing date value is less than the Floor Price in such a case, the target shareholders have been subjected to the economic fortunes of owning the consideration received in the exchange in the same manner as if the contract had fixed the consideration based upon the contract's stated Floor Price. Accordingly, these proposed regulations generally provide that if, pursuant to a binding contract, an item of consideration varies as the value of issuing corporation stock declines between the stock's Pre-Signing Date value and a Floor Price, and the closing date value is less than the Floor Price, COI is determined as if the consideration that would have been delivered at the Floor Price were issued and valued based upon the Floor Price. Applying the same principle, these proposed regulations provide that if, pursuant to a binding contract, an item of consideration varies as the value of issuing corporation stock increases between the stock's signing date value and some higher value provided for in the contract (Ceiling Price), and the closing date value is greater than the Ceiling Price, COI is determined as if the consideration that would have been delivered at the Ceiling Price were issued and valued based upon the Ceiling Price. For purposes of this rule, the Closing Date means the date upon which the exchange of consideration in the potential reorganization occurs.

In response to comments, these proposed regulations also permit, in lieu of the value of issuing corporation stock on the Closing Date, the use of an average value for issuing corporation stock in certain circumstances. The proposed regulations provide that an average value may be used if it is based upon issuing corporation stock values occurring after the signing date and before the Closing Date, and the binding contract utilizes the average price, so computed, in determining the number of shares of each class of stock of the issuing corporation, the amount of money, and the other property to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation. This rule also applies signing date rule principles because the average value fixes the number of shares and amount of other consideration. Accordingly, the target shareholders become subject to the fortunes of the issuer's stock across the range of dates being averaged.

Request for Comments

As previously stated, the signing date rule and these proposed regulations are based upon the concept that for purposes of measuring COI, in certain circumstances an item of consideration provided by the issuing corporation can generally be valued on the date that the target shareholders become subject to the economic fortunes of owning the item, assuming the exchange ultimately occurs. Depending upon the contract's terms, this may occur on a date between the signing date and the closing date, and may occur for different items of consideration on different dates. Accordingly, for purposes of COI, it may be appropriate to value an item of consideration on a date between the signing date and the closing date, and to value different items on different dates. For example, future guidance could provide that an item of consideration is valued for COI purposes at the earliest date on which the target shareholders (in the aggregate) become fully subject to the appreciation and depreciation in the value of that item pursuant to a binding contract to effect the potential reorganization, but not later than the date of the reorganization exchange. In determining whether the target shareholders are fully subject to market appreciation and depreciation, certain circumstances, such as the risk of not closing, would be disregarded. The IRS and the Treasury Department request comments on the propriety of such an approach.

Effective Date

These regulations are proposed to apply to transactions occurring on or after the date the regulations are published as final regulations in the **Federal Register**, unless completed pursuant to a binding agreement that was in effect immediately before the date such final regulations are published and all times afterwards.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866 as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that 5 U.S.C. 553(b) does not apply to these regulations and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.)* does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and 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 will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Richard Starke of the Office of Associate Chief Counsel (Corporate), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.368–1 is amended by adding new paragraphs (e)(2)(vi), (e)(2)(vii), and revising (e)(9) to read as follows:

§1.368–1 Purpose and scope of exception of reorganization exchanges.

* * * * *

(e) * * *

(2) * * *

(vi) *Special Rules*—(A) *Floors*. This paragraph (e)(2)(vi)(A) applies if, pursuant to a binding contract, the amount of an item of consideration to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation, changes as the value of a share of the issuing corporation varies above a specified price (Floor Price), but does not vary below the Floor Price. If the value of the share is greater than or equal to the Floor Price on the Pre-Signing Date (as defined in paragraph (e)(2)(i) of this section) but below the Floor Price on the Closing Date (as defined in paragraph (e)(2)(vi)(D) of this section), whether a proprietary interest is preserved is determined as if the consideration was issued and valued based upon the Floor Price.

(B) *Ceilings*. This paragraph (e)(2)(vi)(B) applies if, pursuant to a binding contract, the amount of an item of consideration to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation, changes as the value of a share of the issuing corporation varies below a specified price (Ceiling Price), but does not vary above the Ceiling Price. If the value of the share is less than or equal to the Ceiling Price on the Pre-Signing Date (as defined in paragraph (e)(2)(i) of this section) but above the Ceiling Price on the Closing Date (as defined in paragraph (e)(2)(vi)(D) of this section), whether a proprietary interest is preserved is determined as if the consideration was issued and valued based upon the Ceiling Price.

(C) *Closing Date value—average values between signing date and Closing Date*. In determining the Closing Date value of issuing corporation stock for purposes of determining whether a proprietary interest in the target corporation is preserved, an average of prices may be used in lieu of the Closing Date price if —

(*1*) The average price is based upon prices of issuing corporation stock occurring after the signing date and before the Closing Date, and

(*2*) The binding contract utilizes the average price, so computed, in determining the number of shares of each class of stock of the issuing corporation, the amount of money, and the other property to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation.

(D) *Closing Date*. For purposes of paragraphs (e)(2)(vi) and (e)(2)(vii) of this section, the *Closing Date* means the date upon which the exchange of consideration in the potential reorganization occurs.

(vii) *Examples*. For purposes of the examples in this paragraph (e)(2)(vii), P is the issuing corporation, T is the target corporation, each corporation has only one class of stock outstanding, no transactions other than those described occur, and the transactions are not otherwise subject to recharacterization. The following examples illustrate the application of paragraph (e)(2)(vi) of this section:

Example 1. Price adjustment to provide more or less cash. (i) *Facts*. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged into P. Pursuant to the contract, the T shareholders will receive 50 shares of P stock and $50 cash in exchange for all of the outstanding shares of T stock, subject to the following price adjustment:

(A) If the average price of P stock over the five-day period prior to the Closing Date exceeds $1, the amount of cash will be reduced by 50 times the excess of that price over $1, and

(B) If the average price of P stock during the specified period is less than $1, the amount of cash will be increased by 50 times the excess of $1 over that price, provided that in no event will P deliver cash of less than $40 or more than $60 to the T shareholders. This adjustment ensures that the T shareholders will be entitled to receive aggregate consideration with a value of $100 on the closing date if the average price of P stock during the specified period is between $.80, at which point the T shareholders would receive $60 of cash ($50 + (($1 - $.80) x 50)), and $1.20, at which point the T shareholders would receive $40 of cash ($50 - (($1.20-$1) x 50)).

(C) On January 2 of year 1, the value of the P stock is $1 per share. On June 1 of year 1, T merges into P, when the value of P stock is $.25 per share. The average price of P stock during the specified period is also $.25 per share. In the merger, the T shareholders receive $60 cash and 50 shares of P stock with a value (determined as of the Closing Date) of $12.50.

(ii) *COI determined at the Floor Price.* For purposes of determining whether a proprietary interest in the target corporation is preserved, the rules of paragraph (e)(2)(vi)(A) of this section apply because, pursuant to a binding contract, the amount of cash to be exchanged for all the proprietary interests in the target corporation varies above a Floor Price of $.80 but does not vary below the Floor Price, the Pre-Signing Date value exceeds the Floor Price, and the value on the Closing Date is less than the Floor Price. Accordingly, whether a proprietary interest is preserved is determined as if the consideration that would have been delivered at the Floor Price was issued and valued based upon the Floor Price value. At the Floor Price, the T shareholders would have received, in the aggregate, $60 of cash and $40 of P stock. Therefore, the transaction satisfies the continuity of interest requirement.

Example 2. *No Floor Price*. The facts are the same as in *Example 1*, except that the Pre-Signing Date value is $.50, the Closing Date value is $1.50, and there is no limitation on the amount of additional cash that the T shareholders may receive (that is, there is no Floor Price). For purposes of determining whether a proprietary interest in the target corporation is preserved, the rules of paragraph (e)(2)(vi)(B) of this section apply because, pursuant to a binding contract, the amount of cash to be exchanged for all the proprietary interests in the target corporation varies below a Ceiling Price of $1.20 but does not vary above the Ceiling Price, the Pre-Signing Date value is less than the Ceiling Price, and the value on the Closing Date exceeds the Ceiling Price. Accordingly, whether a proprietary interest is preserved is determined as if the consideration that would have been delivered at the Ceiling Price was issued and valued based upon the Ceiling Price. At the Ceiling Price, the T shareholders would have received, in the aggregate, $40 of cash and $60 of P stock. Therefore, the transaction satisfies the continuity of interest requirement.

Example 3. No Floor or Ceiling Price. (i) *Facts*. On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged into P. Pursuant to the contract, the T shareholders will receive $50 cash and $50 of P stock based upon the P stock value on the Closing Date. On January 2 of year 1, the Pre-Signing Date, the value of the P stock is $1 per share. On June 1 of year 1, when the value of P stock is $5 per share, T merges into P.

(ii) *COI determined on the Closing Date*. For purposes of determining whether a proprietary interest in the target corporation is preserved, the rules of paragraph (e)(2)(vi) of this section do not apply because the contract does not provide for a either a Floor Price or a Ceiling Price. There is no Floor Price because there is not a value below which the amount of P stock will not vary. There is no Ceiling Price because there is not a value above which the amount of P stock will not vary. Because the transaction does not satisfy the requirements of paragraph (e)(2)(vi) of this section and does not satisfy the definition of fixed consideration, the consideration will be valued on the Closing Date. The transaction satisfies the continuity of interest requirement because the T shareholders receive, in the aggregate, $50 cash and $50 of P stock.

* * * * *

(9) *Effective/Applicability date*. Paragraphs (e)(2)(vi) and (e)(2)(vii) are proposed to apply to transactions occurring on or after the date the regulations are published as final regulations in the **Federal Register**, unless completed pursuant to a binding agreement that was in effect immediately before the date such final regulations are published and at all times afterwards.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on December 16, 2011, 8:45 a.m., and published in the issue of the Federal Register for December 19, 2011, 76 F.R. 78591)

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.

Numerical Finding List[1]

Bulletins 2012–1 through 2012–8

Announcements:

2012-1, 2012-1 I.R.B. *249*
2012-2, 2012-2 I.R.B. *285*
2012-3, 2012-4 I.R.B. *335*
2012-4, 2012-4 I.R.B. *335*
2012-5, 2012-5 I.R.B. *348*
2012-6, 2012-6 I.R.B. *366*
2012-7, 2012-6 I.R.B. *367*
2012-8, 2012-7 I.R.B. *373*
2012-9, 2012-7 I.R.B. *377*

Notices:

2012-1, 2012-2 I.R.B. *260*
2012-3, 2012-3 I.R.B. *289*
2012-4, 2012-3 I.R.B. *290*
2012-5, 2012-3 I.R.B. *291*
2012-6, 2012-3 I.R.B. *293*
2012-7, 2012-4 I.R.B. *308*
2012-8, 2012-4 I.R.B. *309*
2012-9, 2012-4 I.R.B. *315*
2012-10, 2012-5 I.R.B. *343*
2012-11, 2012-5 I.R.B. *346*
2012-12, 2012-6 I.R.B. *365*
2012-14, 2012-8 I.R.B. *411*

Proposed Regulations:

REG-130302-10, 2012-8 I.R.B. *412*
REG-149625-10, 2012-2 I.R.B. *279*
REG-102988-11, 2012-4 I.R.B. *326*
REG-124627-11, 2012-8 I.R.B. *417*
REG-130777-11, 2012-5 I.R.B. *347*

Revenue Procedures:

2012-1, 2012-1 I.R.B. *1*
2012-2, 2012-1 I.R.B. *92*
2012-3, 2012-1 I.R.B. *113*
2012-4, 2012-1 I.R.B. *125*
2012-5, 2012-1 I.R.B. *169*
2012-6, 2012-1 I.R.B. *197*
2012-7, 2012-1 I.R.B. *232*
2012-8, 2012-1 I.R.B. *235*
2012-9, 2012-2 I.R.B. *261*
2012-10, 2012-2 I.R.B. *273*
2012-11, 2012-7 I.R.B. *368*
2012-12, 2012-2 I.R.B. *275*
2012-13, 2012-3 I.R.B. *295*
2012-14, 2012-3 I.R.B. *296*
2012-15, 2012-7 I.R.B. *369*

Revenue Rulings:

2012-1, 2012-2 I.R.B. *255*
2012-2, 2012-3 I.R.B. *286*

Revenue Rulings— Continued:

2012-3, 2012-8 I.R.B. *383*
2012-4, 2012-8 I.R.B. *386*
2012-5, 2012-5 I.R.B. *337*
2012-6, 2012-6 I.R.B. *349*
2012-7, 2012-6 I.R.B. *362*

Treasury Decisions:

9559, 2012-2 I.R.B. *252*
9560, 2012-4 I.R.B. *299*
9561, 2012-5 I.R.B. *341*
9562, 2012-5 I.R.B. *339*
9563, 2012-6 I.R.B. *354*
9565, 2012-8 I.R.B. *378*
9566, 2012-8 I.R.B. *389*
9567, 2012-8 I.R.B. *395*

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

Finding List of Current Actions on Previously Published Items[1]

Bulletins 2012–1 through 2012–8

Announcements:

2011-63
Corrected by
Ann. 2012-9, 2012-7 I.R.B. *377*

Notices:

2010-88
As modified by Ann. 2011-40, is superseded by
Notice 2012-1, 2012-2 I.R.B. *260*

2011-28
Superseded by
Notice 2012-9, 2012-4 I.R.B. *315*

Revenue Procedures:

2003-61
Superseded by
Notice 2012-8, 2012-4 I.R.B. *309*

2007-44
Modified by
Ann. 2012-3, 2012-4 I.R.B. *335*

2011-1
Superseded by
Rev. Proc. 2012-1, 2012-1 I.R.B. *1*

2011-2
Superseded by
Rev. Proc. 2012-2, 2012-1 I.R.B. *92*

2011-3
Superseded by
Rev. Proc. 2012-3, 2012-1 I.R.B. *113*

2011-4
Superseded by
Rev. Proc. 2012-4, 2012-1 I.R.B. *125*

2011-5
Superseded by
Rev. Proc. 2012-5, 2012-1 I.R.B. *169*

2011-6
Superseded by
Rev. Proc. 2012-6, 2012-1 I.R.B. *197*

2011-7
Superseded by
Rev. Proc. 2012-7, 2012-1 I.R.B. *232*

2011-8
Superseded by
Rev. Proc. 2012-8, 2012-1 I.R.B. *235*

2011-9
Superseded by
Rev. Proc. 2012-9, 2012-2 I.R.B. *261*

Revenue Procedures— Continued:

2011-10
Superseded by
Rev. Proc. 2012-10, 2012-2 I.R.B. *273*

2011-40
Corrected by
Ann. 2012-6, 2012-6 I.R.B. *366*

2011-49
Modified by
Ann. 2012-3, 2012-4 I.R.B. *335*

2011-50
Corrected by
Ann. 2012-6, 2012-6 I.R.B. *366*

2011-51
Corrected by
Ann. 2012-6, 2012-6 I.R.B. *366*

2012-8
Corrected by
Ann. 2012-7, 2012-6 I.R.B. *367*

Revenue Rulings:

92-19
Supplemented in part by
Rev. Rul. 2012-6, 2012-6 I.R.B. *349*

2008-40
Modified by
Notice 2012-6, 2012-3 I.R.B. *293*

2011-1
Modified by
Notice 2012-6, 2012-3 I.R.B. *293*

Treasury Decision:

9517
Corrected by
Ann. 2012-4, 2012-4 I.R.B. *335*
Ann. 2012-5, 2012-5 I.R.B. *348*

[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

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