INTERNAL REVENUE
BULLETIN

Bulletin No. 2015–32
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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

REG–115452–14, page 158.

These proposed regulations provide guidance to partnerships and their partners regarding when an arrangement will be treated as a disguised payment for services under section 707(a)(2)(A) of the Internal Revenue Code. This document also proposes conforming modifications to the regulations governing guaranteed payments under section 707(c). Additionally, this document provides notice of proposed modifications to Rev. Procs. 93–27 and 2001–43 relating to the issuance of interests in partnership profits to service providers.

T.D. 9727, page 154.

This document contains final regulations for filing a claim for credit or refund.

EMPLOYEE PLANS

Announcement 2015–19, page 157.

This announcement describes future changes to the determination letter program for qualified individually designed plans and sets forth an intended transition period for certain plans. This announcement requests comments on specific issues relating to the implementation of these changes. This announcement also provides that effective July 21, 2015, the IRS will no longer accept determination letter applications that are submitted off-cycle (except as otherwise described in the announcement).

EMPLOYMENT TAX

T.D. 9727, page 154.

This document contains final regulations for filing a claim for credit or refund.

ADMINISTRATIVE

T.D. 9727, page 154.

This document contains final regulations for filing a claim for credit or refund.

Finding Lists begin on page ii.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

T.D. 9727

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Claims for Credit or Refund

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations for filing a claim for credit or refund. The regulations provide guidance to taxpayers generally as to the proper place to file a claim for credit or refund. The regulations are updated to reflect changes made by the Tax Reform Act of 1976, section 1210, the Internal Revenue Service Restructuring and Reform Act of 1998, and the Community Renewal Tax Relief Act of 2000. The regulations are further updated to reflect that the IRS may prescribe additional claim forms.

DATES: *Effective Date*: These regulations are effective on July 24, 2015.

Applicability Dates: For dates of applicability, see §§ 301.6402–2(g), 301.6402–3(f) and 301.6402–4(b).

FOR FURTHER INFORMATION CONTACT: Micah A. Levy, (202) 317-6832 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

These final regulations amend current regulations under section 6402 of the Internal Revenue Code (Code). Section 6402 of the Code authorizes the Secretary to make credits or refunds of overpayments. Section 6511 provides the limitations period within which a taxpayer must file a claim for credit or refund and restricts the ability of the Secretary to issue a credit or refund unless the claim is filed by the taxpayer within that period. Section 7422 prohibits the maintenance of a suit for refund until a claim has been duly filed with the Secretary. Currently, § 301.6402–2(a)(2) provides generally that a claim for credit or refund must be filed with the service center serving the internal revenue district in which the tax was paid. These final regulations clarify that, unless otherwise directed, the proper place to file a claim for credit or refund is with the service center at which the taxpayer currently would be required to file a tax return for the type of tax to which the claim relates, irrespective of where the tax was paid or was required to have been paid.

These final regulations remove outdated portions of § 301.6402–2 that provided rules for claims filed prior to April 15, 1968 and § 301.6402–3 that provided special rules for claims for credit or refund of income taxes filed before July 1, 1976, and revises the reference in § 301.6402–4 to reflect the threshold for referral to the Joint Committee on Taxation pursuant to section 6405. These final regulations do not affect § 301.6402–3T as promulgated in Treasury Decision 9658 (79 FR 12880) (March 6, 2014). Other stylistic revisions were adopted solely to conform the regulations to modern drafting style and usage.

On June 10, 2011, the IRS published a notice of proposed rulemaking (REG–137128–08) in the **Federal Register** (76 FR 34017). No request for a public hearing was received. The IRS received written and electronic comments responding to the notice of proposed rulemaking. After consideration of the comments, the proposed regulations are adopted as amended by this Treasury decision. All comments are available at *www.regulations.gov* or upon request.

Explanation of Provisions and Summary of Comments

I. *Electronic Filing*

Commentators suggested that the regulations should provide for electronic filing, when available. Although the final regulations do not explicitly refer to electronic filing, the final regulations instruct taxpayers to file a claim for credit or refund in a manner consistent with forms, form instructions, publications, and other guidance on the IRS website. To the extent that electronic filing is or becomes available for filing a claim for credit or refund, it will be described elsewhere – for example, in forms, form instructions, publications, or the IRS website.

2. *Claims Unrelated to a Tax for Which a Return Is Required*

Commentators noted that some penalties are not related to any tax for which a return is required. These commentators observed that the instructions to Form 843, "Claim for Refund and Request for Abatement," that taxpayers use to file a claim for credit or refund of penalties that are unrelated to any tax for which a return is required are unhelpful because they instruct taxpayers to file Form 843 with the service center in which the taxpayer would be required to file a current tax return for "the tax to which your claim or request relates." For an assessable penalty that is unrelated to a particular tax, the notice containing or issued along with demand for payment would provide the proper address for filing a claim for credit or refund and the taxpayer should file a claim in accordance with any specific instructions contained therein.

The locations at which the IRS processes the various forms for any given subset of taxpayers may change and the proper place to identify such locations is in the various forms, instructions, publications, and the IRS.gov website. These regulations appropriately cross-reference such authorities.

3. *Protective and Informal Claims*

Commentators suggested that the regulations be amended to discuss protective claims and informal claims. Although not provided for in the Code, case law provides that protective claims may be filed to preserve a taxpayer's right to claim a refund when the taxpayer's right to the refund is contingent on future events and may not be determinable until after the statute of limitations expires. Case law also provides that a claim for refund that is technically deficient with respect to some formal claim requirement (*that is*, an "informal" claim) might nonetheless be a valid claim as long as it meets certain basic requirements (for example, even an informal claim must contain a written component). While the IRS has recognized both protective and informal claims in some circumstances, neither is within the scope of these regulations.

4. *Authority to Make Refunds on Equitable Grounds*

Commentators suggested that Treas. Reg. sec. 301.6402–2(b)(2), which explains that the IRS lacks the authority to make a refund on equitable grounds, should include exceptions for sections 6015(f) and 6343(d). Those and other Code provisions allow the IRS to consider equitable factors in making certain determinations, such as whether a taxpayer is eligible for innocent spouse relief or whether a levy may be released. The equitable factors that the IRS may consider in these statutorily prescribed situations affect only whether the taxpayer has an overpayment or otherwise may be entitled to particular relief. Once an overpayment is determined, whether by taking equitable considerations into account or not, such overpayment may be refunded only if the taxpayer or IRS follows all of the statutory and administrative prerequisites required to allow and make a refund. *See United States v. Clinton Elkhorn Mining Co.*, 553 U.S. 1 (2008). None of those equitable factors otherwise determine whether or how the IRS is to issue a refund. Section 6402, in turn, prescribes the treatment of overpayments and provides the regime under which the IRS may issue a refund. In other words, although equitable considerations may be taken into account under some Code sections in determining either the existence or amount of an overpayment, those sections do not provide any authority (equitable or statutory) to allow or make credits and refunds under section 6402. The statutory language of section 6402(a) provides that, if there is an overpayment, then the IRS *shall* refund that overpayment (subject to certain exceptions enumerated in the statute).

The IRS has discretion to grant equitable relief from joint and several liability under section 6015(f) to a requesting spouse if, considering all of the facts and circumstances, it would be inequitable to hold the requesting spouse jointly and severally liable. In those cases in which the IRS does apply equitable factors to determine whether a taxpayer is in an overpayment situation, such as under section 6015(f), the IRS considers things such as (1) whether the taxpayer is divorced, (2) whether the tax liability is due to income of the non-requesting spouse, and (3) the health of the requesting spouse. *See*, Rev. Proc. 2013–34, 2013–43 IRB 397 (Sept. 16, 2013). When a requesting spouse is relieved of joint and several liability, relief will rarely result in an overpayment because equitable relief under section 6015(f) generally involves unpaid liabilities. As a result, in many cases in which the IRS determines that a requesting spouse is entitled to equitable relief, the IRS ceases collection activity against the requesting spouse for any due, but unpaid, tax liabilities. Nonetheless, when equitable relief does result in an overpayment, the requesting spouse may receive a refund by filing a claim for refund using a Form 8857, Request for Innocent Spouse Relief, that complies with section 6402. Thus, the equitable considerations in section 6015(f) relate to whether the requesting spouse is entitled to relief, not whether a resulting overpayment is refunded.

Section 6343(d) provides for the return of levied property to a taxpayer in certain circumstances, including when, "with the consent of the taxpayer or the National Taxpayer Advocate, the return of such property would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States." Although section 6343(d) may allow the IRS to consider equitable factors in determining whether to return the property, the return of levied property does not affect the amount of a taxpayer's tax liability and will not result in an overpayment. Accordingly, if the IRS returns property under section 6343(d) and the taxpayer fails to pay the previously assessed liability for which the levy was made on the returned property, then the IRS may collect the liability again, administratively or otherwise.

The refund provisions of section 6402 are only triggered once an overpayment exists and is established. Indeed, the section begins "[i]n the case of any overpayment. . . ." By presupposing the existence of an overpayment, the equitable factors that the IRS may have considered are not implicated or relevant in the determination of whether the overpayment is credited or refunded. Moreover, once the equitable factors have been used to establish the taxpayer's ability to claim a refund, the amount of any overpayment is a purely mathematical calculation—no equitable factors exist at this stage. The final regulations continue to make clear that the IRS lacks the authority to refund on equitable grounds penalties or other amounts legally collected that comprise an overpayment.

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to the regulations and, therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comments on its impact on small business, and no comments were received.

Drafting Information

The principal author of the regulations is Micah A. Levy, Office of the Associate Chief Counsel (Procedure & Administration). Mr. Levy can be reached at (202) 317-6832 (not a toll-free number).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6402–2 is amended by:

1. Revising paragraphs (a)(2), (b)(2), (c), and (d).

2. Adding paragraph (g).

The revisions and addition read as follows:

§ 301.6402–2 Claims for credit or refund.

(a) * * *

(2) Except as provided in paragraph (b) of § 301.6091–1 (relating to hand-carried documents), if a taxpayer is required to file a claim for credit or refund using a particular form, then the claim, together with appropriate supporting evidence, shall be filed in a manner consistent with such form, form instructions, publications, or other guidance found on the IRS.gov website. If a taxpayer is filing a claim in response to an IRS notice or correspondence, then the claim must be filed in accordance with the specific instructions contained in the notice or correspondence regarding the manner of filing. Any other claim not described in the preceding sentences generally must be filed with the service center at which the taxpayer currently would be required to file a tax return for the type of tax to which the claim relates or via the appropriate electronic portal. For rules relating to interest in the case of credits or refunds, see section 6611. For rules treating timely mailing as timely filing, see section 7502. For rules relating to the time for filing a claim when the last day falls on Saturday, Sunday, or a legal holiday, see section 7503.

(b) * * *

(2) The IRS does not have the authority to refund on equitable grounds penalties or other amounts legally collected.

(c) *Form for filing claim*. If a particular form is prescribed on which the claim must be made, then the claim must be made on the form so prescribed. For special rules applicable to refunds of income taxes, see § 301.6402–3. For provisions relating to credits and refunds of taxes other than income tax, see the regulations relating to the particular tax. All claims by taxpayers for the refund of taxes, interest, penalties, and additions to tax that are not otherwise provided for must be made on Form 843, "Claim for Refund and Request for Abatement."

(d) *Separate claims for separate taxable periods*. In the case of income and gift taxes, income tax withheld, taxes under the Federal Insurance Contributions Act, taxes under the Railroad Retirement Tax Act, and taxes under the Federal Unemployment Tax Act, a separate claim must be made for each return for each taxable period.

* * * * *

(g) *Effective/applicability date*. Paragraphs (a)(2), (b)(2), (c), and (d) of this section apply to claims for credit or refund filed on or after July 24, 2015. Paragraphs (a)(1), (b)(1), (e), and (f) of this section apply to claims for credit or refund filed before, on or after July 24, 2015.

Par. 3. Section 301.6402–3 is amended by:

1. Revising the introductory text of paragraph (a).

2. Removing and reserving paragraph (b).

3. Revising paragraphs (c) and (f).

The revisions read as follows:

§ 301.6402–3 Special rules applicable to income tax.

(a) The following rules apply to a claim for credit or refund of income tax:—

* * * * *

(b) [Reserved]

(c) If the taxpayer is not required to show the tax on the form (see section 6014 and the accompanying regulations), the IRS will treat a properly filed income tax return as a claim for refund and such return will constitute a claim for refund within the meaning of section 6402 and section 6511 for the amount of the overpayment shown by the computation of the tax made by the IRS on the basis of the return. For purposes of the limitations period of section 6511, such claim will be treated as filed on the date the return is treated as filed.

* * * * *

(f) *Effective/applicability date*. (1) Paragraph (c) of this section, as revised, applies to claims for credit or refund filed on or after July 24, 2015. Paragraphs (a) (d) and (e) of this section apply to claims for credit or refund filed before, on or after July 24, 2015, except references in paragraph (e) to Form 8805 or other statements required under § 1.1446–3(d)(2) of this chapter apply to partnership taxable years beginning after April 29, 2008.

(2) [Reserved]. For further guidance, see § 301.6402–3T(f)(2).

Par. 4. Section 301.6402–4 is revised to read as follows:

§ 301.6402–4 Payments in excess of amounts shown on return.

(a) If the IRS determines that the payments by the taxpayer that are made within the period prescribed for payment and before the filing of the return exceed the amount of tax shown on the return (for example, excessive estimated income tax payments or excessive withholding), the IRS may credit or refund such overpayment without awaiting examination of the completed return and without awaiting the filing of a claim for refund. The provisions of §§ 301.6402–2 and 301.6402–3 are applicable to such overpayment, and taxpayers should submit claims for refund (if the income tax return is not itself a claim for refund, as provided in § 301.6402–3) to protect themselves in the event the IRS fails to make such determination and credit or refund. The provisions of section 6405 (relating to reports of refunds in excess of the statutorily prescribed threshold referral amount to the Joint Committee on Taxation) do not apply to the overpayments described in this section.

(b) *Effective/applicability date*. The rules of this section apply to payments made on or after July 24, 2015.

John Dalrymple
Deputy Commissioner for Services and Enforcement.

Approved: July 8, 2015

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

(Filed by the Office of the Federal Register on July 23, 2015, 8:45 a.m., and published in the issue of the Federal Register for July 24, 2015, 80 F.R. 43949)

Part IV. Items of General Interest

Revisions to the Employee Plans Determination Letter Program

Announcement 2015–19

PURPOSE

This announcement describes important changes to the Employee Plans determination letter program for qualified retirement plans. Based on the need of the Internal Revenue Service (IRS) to more efficiently direct its limited resources, effective January 1, 2017, these changes will eliminate the staggered 5-year determination letter remedial amendment cycles for individually designed plans and will limit the scope of the determination letter program for individually designed plans to initial plan qualification and qualification upon plan termination. This announcement also provides a transition rule with respect to the remedial amendment period for certain plans currently on the 5-year cycle. The IRS is requesting comments on specific issues relating to the implementation of these changes to the determination letter program. The changes to the determination letter filing procedures described in this announcement will be reflected in an update to Rev. Proc. 2007–44, 2007–2 C.B. 54, and in a successor to Rev. Proc. 2015–6, 2015–1 I.R.B. 194.

In addition to announcing changes that will be made to the determination letter program, this announcement provides that, effective July 21, 2015, the IRS will no longer accept determination letter applications that are submitted off-cycle, except as otherwise described below.

In connection with the modifications to the determination letter program described in this announcement, the Department of the Treasury (Treasury) and the IRS are considering ways to make it easier for plan sponsors to comply with the qualified plan document requirements. This may include, in appropriate circumstances, providing model amendments, not requiring certain plan provisions or amendments to be adopted if and for so long as they are not relevant to a particular plan (for example, because of the type of plan, employer, or benefits offered), or expanding plan sponsors' options to document qualification requirements through incorporation by reference.

BACKGROUND

Section 401(b) of the Internal Revenue Code (Code) provides a remedial amendment period during which a plan may be amended retroactively to comply with the Code's qualification requirements. Section 1.401(b)–1 describes the disqualifying provisions that may be amended retroactively and the remedial amendment period during which retroactive amendments may be adopted. Section 1.401(b)–1(f) provides that the Commissioner may extend the remedial amendment period at the Commissioner's discretion.

Revenue Procedure 2007–44 sets forth procedures for issuing determination letters and describes the 5-year remedial amendment cycle for individually designed plans. Under these procedures, sponsors of individually designed plans generally are permitted to apply for determination letters once every 5 years. Section 5.03 of Rev. Proc. 2007–44 extends the remedial amendment period for the disqualifying provisions described in 5.03(1) and (2) to the end of a plan's applicable remedial amendment cycle. Section 9 of Rev. Proc. 2007–44 provides the rules and procedures for the 5-year remedial amendment cycles. In general, a plan's 5-year remedial amendment cycle is determined by reference to the last digit of the employer identification number of the employer that sponsors the plan.

Section 5.02 of Rev. Proc. 2007–44 provides that an interim amendment is a plan amendment with respect to a disqualifying provision described in section 5.01(1) or (2) of that revenue procedure. Generally, pursuant to Section 5.05 of Rev. Proc. 2007–44, interim amendments must be adopted by the later of (1) the due date (including extensions) for filing the income tax return for the employer's taxable year that includes the date on which the remedial amendment period begins, or (2) the last day of the plan year that includes the date the remedial amendment period begins.

Under section 14.01 of Rev. Proc. 2007–44, a plan's determination letter application is filed off-cycle if it is submitted anytime other than during the last 12-month period of a plan's remedial amendment cycle (that is, the 12-month period ending on January 31 of the last year of the cycle).

CHANGES TO THE DETERMINATION LETTER PROGRAM

Elimination of 5-Year Remedial Amendment Cycles

Effective January 1, 2017, the IRS will eliminate the staggered 5-year remedial amendment cycles for individually designed plans. As of that date, the IRS will no longer accept determination letter applications based on the 5-year remedial amendment cycles. However, sponsors of Cycle A plans, described in section 9.03 of Rev. Proc. 2007–44, will continue to be permitted to submit determination letter applications during the period beginning February 1, 2016, and ending January 31, 2017.

Effective January 1, 2017, a sponsor of an individually designed plan will be permitted to submit a determination letter application for a plan on initial plan qualification (that is, a plan for which a Form 5300, *Application for Determination for Employee Benefit Plan*, has not been filed or for which a Form 5300 has been filed but a determination letter was not issued with respect to the plan, regardless of when the plan was adopted) and for qualification upon plan termination. In addition, a sponsor will be permitted to submit a determination letter application in certain other limited circumstances that will be determined by Treasury and the IRS. Treasury and the IRS intend to request comments periodically from the public regarding the other limited circumstances under which a plan sponsor will be eligible to apply for a determination letter. Treasury and the IRS will identify those circumstances in published guidance on a periodic basis.

Transition Period for Individually Designed Plans

Section 5.03 of Rev. Proc. 2007–44 extends the remedial amendment period for disqualifying provisions described in section 5.03(1) and (2) to the end of a plan's applicable remedial amendment cycle. As a result of the elimination of the 5-year remedial amendment cycles, the extension of the remedial amendment period provided in section 5.03 will not be available after December 31, 2016, and the remedial amendment period definition in § 1.401(b)–1 will apply. However, the Commissioner intends to extend the remedial amendment period for individually designed plans to a date that is expected to end no earlier than December 31, 2017.

Immediate Elimination of Off-Cycle Determination Letter Applications

Effective July 21, 2015, through December 31, 2016, the IRS will no longer accept off-cycle determination letter applications, as defined in section 14 of Rev. Proc. 2007–44, except for determination letter applications for new plans, as defined in section 14.02(2) of Rev. Proc. 2007–44, and for terminating plans.

REQUEST FOR COMMENTS

The IRS requests comments on the following issues:

(1) What changes should be made to the remedial amendment period that would otherwise apply to individually designed plans under § 401(b)?

(2) Treasury and the IRS have received numerous comments concerning the rules relating to interim amendments, as described in section 5 of Rev. Proc. 2007–44. In view of the changes being made to the determination letter program, what additional considerations should be taken into account in connection with the current interim amendment requirement?

(3) What guidance should be issued to assist plan sponsors that wish to convert an individually designed plan into a pre-approved plan?

(4) What changes should be made to other IRS programs to facilitate the changes described in this announcement, including revisions to the Employee Plans Compliance Resolution System set forth in Rev. Proc. 2013–12, 2013–4 I.R.B. 313, as modified by Rev. Proc. 2015–27, 2015–16 I.R.B. 914, and Rev. Proc. 2015–28, 2015–16 I.R.B. 920?

Comments may be submitted in writing on or before October 1, 2015. Comments should be mailed to Internal Revenue Service, CC:PA:LPD:PR (Announcement 2015–19), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, or sent electronically to notice.comments @irscounsel.treas.gov. Please include "Announcement 2015–19" in the subject line of any electronic communications. Alternatively, comments may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (Announcement 2015–19), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, D.C. All comments will be available for public inspection and copying.

The principal author of this announcement is Angelique Carrington of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this announcement, contact Ms. Carrington at (202) 317-4148 (not a toll-free number).

Disguised Payments for Services

REG–115452–14

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to disguised payments for services under section 707(a)(2)(A) of the Internal Revenue Code. The proposed regulations provide guidance to partnerships and their partners regarding when an arrangement will be treated as a disguised payment for services. This document also proposes conforming modifications to the regulations governing guaranteed payments under section 707(c). Additionally, this document provides notice of proposed modifications to Rev. Procs. 93–27 and 2001–43 relating to the issuance of interests in partnership profits to service providers.

DATES: Written and electronic comments and requests for a public hearing must be received by October 21, 2015.

ADDRESSES: Send submissions to CC: PA:LPD:PR (REG–115452–14), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–115452–14), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov* (indicate IRS and REG–115452–14).

FOR FURTHER INFORMATION CONTACT: Concerning submissions of comments, Oluwafunmilayo (Funmi) Taylor (202) 517-6901; concerning the proposed regulations, Jaclyn M. Goldberg (202) 317-6850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Generally, under the statutory framework of Subchapter K of the Code, an allocation or distribution between a partnership and a partner for the provision of services can be treated in one of three ways: (1) a distributive share under section 704(b); (2) a guaranteed payment under section 707(c); or (3) as a transaction in which a partner has rendered services to the partnership in its capacity as other than a partner under section 707(a).

Distributive Share Treatment

Partnership allocations that are determined with regard to partnership income and that are made to a partner for services rendered by the partner in its capacity as a partner are generally treated as distributive shares of partnership income, taxable under the general rules of sections 702, 703, and 704. In some cases, the right to a distributive share may qualify as a profits interest defined in Rev. Proc. 93–27, 1993–2 C.B. 343. Rev. Proc. 93–27, clarified by Rev. Proc. 2001–43, 2001–2 C.B. 191, provides guidance on the treatment of the receipt of a profits interest for services provided to or for the benefit of the partnership.

Arrangements subject to sections 707(c) or 707(a)(1).

In 1954, Congress added section 707 to the Code to clarify transactions between a partner and a partnership. Section 707(a) addresses arrangements in which a partner engages with the partnership other than in its capacity as a partner. The legislative history to section 707(a) provides the general rule that a partner who engages in a transaction with the partnership, other than in its capacity as a partner is treated as though it were not a partner. The provision was intended to apply to the sale of property by the partner to the partnership, the purchase of property by the partner from the partnership, and the rendering of services by the partner to the partnership or by the partnership to the partner. H.R. Rep. No. 1337, 83d Cong., 2d Sess. 227 (1954) (House Report); S. Rep. No. 1622, 83d Cong., 2d Sess. 387 (1954) (Senate Report).

Congress simultaneously added section 707(c) to address payments to partners of the partnership acting in their partner capacity. Section 707(c) provides that to the extent determined without regard to the income of the partnership, payment to a partner for services shall be considered as made to a person who is not a partner, but only for purposes of sections 61(a) and 162(a). The Senate Report and the House Report provide that a fixed salary, payable without regard to partnership income, to a partner who renders services to the partnership is a guaranteed payment. The amount of the payment shall be included in the partner's gross income, and shall not be considered a distributive share of income or gain. A partner who is guaranteed a minimum annual amount for its services shall be treated as receiving a fixed payment in that amount. House Report at 227; Senate Report at 387.

In 1956, the Treasury Department and the IRS issued additional guidance under § 1.707–1 relating to a partner not acting in its capacity as a partner under section 707(a) and to guaranteed payments under section 707(c). See TD 6175. However, it remained unclear when a partner's services to the partnership were rendered in a non-partner capacity under section 707(a) rather than in a partner capacity under section 707(c).

In 1975, the Tax Court distinguished sections 707(a) and 707(c) payments in *Pratt v. Commissioner*, 64 T.C. 204 (1975), *aff'd* in part, *rev'd* in part, 550 F.2d 1023 (5th Cir. 1977). In *Pratt*, the general partners in two limited partnerships formed to purchase, develop, and operate two shopping centers received a fixed percentage of gross rentals in exchange for the performance of managerial services. The Tax Court held that these payments were not guaranteed payments under section 707(c) because they were computed based on a percentage of gross rental income and therefore were not paid without regard to partnership income. The Tax Court further held that section 707(a) did not apply because the general partners performed managerial duties in their partner capacities in accordance with their basic duties under the partnership agreement. On appeal, the Fifth Circuit affirmed the Tax Court's decision. The Fifth Circuit reasoned that Congress enacted section 707(a) to apply to partners who perform services for the partnership that are outside the scope of the partnership's activities. The Court indicated that if the partner performs services that the partnership itself provides, then the compensation to the service provider is merely a rearrangement among the partners of their distributive shares in the partnership income.

In response to the decision in *Pratt*, the Treasury Department and the IRS issued Rev. Rul. 81–300, 1981–2 C.B. 143 and Rev. Rul. 81–301, 1981–2 C.B. 144 to clarify the treatment of transactions under sections 707(a) and 707(c). As in the *Pratt* case, Rev. Rul. 81–300 considers a partnership formed to purchase, develop, and operate a shopping center. The partnership agreement required the general partners to contribute their time, managerial abilities, and best efforts to the partnership. In return for these services, the general partners received a fee equal to five percent of the partnership's gross rental income. The ruling concluded that the taxpayers performed managerial services in their capacities as general partners, and characterized the management fees as guaranteed payments under section 707(c). The ruling provides that, although guaranteed payments under section 707(c) frequently involve a fixed amount, they are not limited to fixed amounts. Thus, the ruling concluded that a payment for services determined by reference to an item of gross income will be a guaranteed payment if, on the basis of all facts and circumstances, the payment is compensation rather than a share of profits.

Rev. Rul. 81–301 describes a limited partnership which has two classes of general partners. The first class of general partner (director general partners) had complete control over the management, conduct, and operation of partnership activities. The second class of general partner (adviser general partner) rendered to the partnership services that were substantially the same as those that the adviser general partner rendered to other persons as an independent contractor. The adviser general partner received 10 percent of daily gross income in exchange for the management services it provided to the partnership. Rev. Rul. 81–301 held that the adviser general partner received its gross income allocation in a non-partner capacity under section 707(a) because the adviser general partner provided similar services to other parties, was subject to removal by the director general partners, was not personally liable to the other partners for any losses, and its management was supervised by the director general partners.

Enactment of Section 707(a)(2)(A)

Congress revisited the scope of section 707(a) in 1984, in part to prevent partners from circumventing the capitalization requirements of sections 263 and 709 by structuring payments for services as allocations of partnership income under section 704. H.R. Rep. No. 432 (Pt. 2), 98th Cong., 2d Sess. 1216–21 (1984) (H.R. Rep.); S. Prt. No. 169 (Vol. 1), 98th Cong., 2d Sess. 223–32 (1984) (S. Prt.). Congress specifically addressed the holdings in Rev. Rul. 81–300 and Rev. Rul. 81–301, affirming Rev. Rul. 81–301 and concluding that the payment in Rev. Rul. 81–300 should be recharacterized as a section 707(a) payment. S. Prt. at 230. Accordingly, the Treasury Department and the IRS are obsoleting Rev. Rul. 81–300 and request comments on whether it should be reissued with modified facts.

Congress also added an anti-abuse rule to section 707(a) relating to payments to partner service providers. Section 707(a)(2)(A) provides that if a partner performs services for a partnership and receives a related direct or indirect allocation and distribution, and the performance of services and allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in its capacity as a partner, the transaction will be treated as occurring between the partnership and one who is not a partner under section 707(a)(1). See section 73 of the Tax Reform Act of 1984 (the 1984 Act). The Treasury Department and the IRS have concluded that section 707(a)(2) applies to arrangements in which distributions to the service provider depend on an allocation of an item of income, and section 707(c) applies to amounts whose payments are unrelated to partnership income.

Section 707(a)(2) grants the Secretary broad regulatory authority to identify transactions involving disguised payments for services under section 707(a)(2)(A). This grant of regulatory authority stems from Congress's concern that partnerships and service providers were inappropriately treating payments as allocations and distributions to a partner even when the service provider acted in a capacity other than as a partner. S. Prt. at 225. Congress determined that allocations and distributions that were, in substance, direct payments for services should be treated as a payment of fees rather than as an arrangement for the allocation and distribution of partnership income. H.R. Rep. at 1218; S. Prt. at 225. Congress differentiated these arrangements from situations in which a partner receives an allocation (or increased allocation) for an extended period to reflect its contribution of property or services to the partnership, such that the partner receives the allocation in its capacity as a partner. In balancing these potentially conflicting concerns, Congress anticipated that the regulations would take five factors into account in determining whether a service provider would receive its putative allocation and distribution in its capacity as a partner. H.R. Rep. at 1219–20; S. Prt. at 227.

Congress identified as its first and most important factor whether the payment is subject to significant entrepreneurial risk as to both the amount and fact of payment. In explaining why entrepreneurial risk is the most important factor, Congress provides that "[p]artners extract the profits of the partnership with reference to the business success of the venture, while third parties generally receive payments which are not subject to this risk." S. Prt. at 227. An arrangement for an allocation and distribution to a service provider which involves limited risk as to amount and payment is treated as a fee under section 707(a)(2)(A). Congress specified examples of allocations that presumptively limit a partner's risk, including (i) capped allocations of income, (ii) allocations for a fixed number of years under which the income that will go to the partner is reasonably certain, (iii) continuing arrangements in which purported allocations and distributions are fixed in amount or reasonably determinable under all facts and circumstances, and (iv) allocations of gross income items.

An arrangement in which an allocation and distribution to a service provider are subject to significant entrepreneurial risk as to amount will generally be recognized as a distributive share, although other factors are also relevant. The legislative history to section 707(a)(2)(A) includes the following examples of factors that could bear on this determination: (i) whether the partner status of the recipient is transitory; (ii) whether the allocation and distribution that are made to the partner are close in time to the partner's performance of services; (iii) whether the facts and circumstances indicate that the recipient became a partner primarily to obtain tax benefits for itself or the partnership that would not otherwise have been available; and (iv) whether the value of the recipient's interest in general and in continuing partnership profits is small in relation to the allocation in question.

Explanation of Provisions

Section 1.707–1 sets forth general rules on the operation of section 707. Section 1.707–2 is titled "Disguised payments for services" and is currently reserved. Sections 1.707–3 through 1.707–7 provide guidance regarding transactions involving disguised sales under section 707(a)(2)(B). These proposed regulations are issued under § 1.707–2 and provide guidance regarding transactions involving disguised payments for services under section 707(a)(2)(A). The effective date of the proposed regulations is provided under § 1.707–9.

I. *General Rules Regarding Disguised Payments for Services*

A. *Scope*

Consistent with the language of section 707(a)(2)(A), § 1.707–2(b) of the proposed regulations provides that an arrangement will be treated as a disguised payment for services if (i) a person (service provider), either in a partner capacity or in anticipation of being a partner, performs services (directly or through its delegate) to or for the benefit of the partnership; (ii) there is a related direct or indirect allocation and distribution to the service provider; and (iii) the performance of the services and the allocation and distribution when viewed together, are properly characterized as a transaction occurring between the partnership and a person acting other than in that person's capacity as a partner.

The proposed regulations provide a mechanism for determining whether or not an arrangement is treated as a disguised payment for services under section 707(a)(2)(A). An arrangement that is treated as a disguised payment for services under these proposed regulations will be treated as a payment for services for all purposes of the Code. Thus, the partnership must treat the payments as payments to a non-partner in determining the remaining partners' shares of taxable income or loss. Where appropriate, the partnership must capitalize the payments or otherwise treat them in a manner consistent with the recharacterization.

The consequence of characterizing an arrangement as a payment for services is otherwise beyond the scope of these regulations. For example, the proposed regulations do not address the timing of inclusion by the service provider or the timing of a deduction by the partnership other than to provide that each is taken into account as provided for under applicable law by applying all relevant sections of the Code and all relevant judicial doctrines. Further, if an arrangement is subject to section 707(a), taxpayers should look to relevant authorities to determine the status of the service provider as an independent contractor or employee. *See generally* Rev. Rul. 69–184, 1969–1 C.B. 256. The Treasury Department and the IRS believe that section 707(a)(2)(A) generally should not apply to arrangements that the partnership has reasonably characterized as a guaranteed payment under section 707(c).

Allocations pursuant to an arrangement between a partnership and a service provider to which sections 707(a) and 707(c) do not apply will be treated as a distributive share under section 704(b). Rev. Proc. 93–27 and Rev. Proc. 2001–43 may apply to such an arrangement if the specific requirements of those Revenue Procedures are also satisfied. The Treasury Department and the IRS intend to modify the exceptions set forth in those revenue procedures to include an additional exception for profits interests issued in conjunction with a partner forgoing payment of a substantially fixed amount. This exception is discussed in part IV of the Explanation of Provisions section of this preamble.

B. *Application and Timing*

These proposed regulations apply to a service provider who purports to be a partner even if applying the regulations causes the service provider to be treated as a person who is not a partner. S. Prt. at 227. Further, the proposed regulations may apply even if their application results in a determination that no partnership exists. The regulations also apply to a special allocation and distribution received in exchange for services by a service provider who receives other allocations and distributions in a partner capacity under section 704(b).

The proposed regulations characterize the nature of an arrangement at the time at which the parties enter into or modify the arrangement. Although section 707(a)(2)(A)(ii) requires both an allocation and a distribution to the service provider, the Treasury Department and the IRS believe that a premise of section 704(b) is that an income allocation correlates with an increased distribution right, justifying the assumption that an arrangement that provides for an income allocation should be treated as also providing for an associated distribution for purposes of applying section 707(a)(2)(A). The Treasury Department and the IRS considered that some arrangements provide for distributions in a later year, and that those later distributions may be subject to independent risk. However, the Treasury Department and the IRS believe that recharacterizing an arrangement retroactively is administratively difficult. Thus, the proposed regulations characterize the nature of an arrangement when the arrangement is entered into (or modified) regardless of when income is allocated and when money or property is distributed. The proposed regulations apply to both one-time transactions and continuing arrangements. S. Prt. at 226.

II. *Factors Considered*

Whether an arrangement constitutes a payment for services (in whole or in part) depends on all of the facts and circumstances. The proposed regulations include six non-exclusive factors that may indicate that an arrangement constitutes a disguised payment for services. Of these factors, the first five factors generally track the facts and circumstances identified as relevant in the legislative history for purposes of applying section 707(a)(2)(A). The proposed regulations also add a sixth factor not specifically identified by Congress. The first of these six factors, the existence of significant entrepreneurial risk, is accorded more weight than the other factors, and arrangements that lack significant entrepreneurial risk are treated as disguised payments for services. The weight given to each of the other five factors depends on the particular case, and the absence of a particular factor (other than significant entrepreneurial risk) is not necessarily determinative of whether an arrangement is treated as a payment for services.

A. *Significant Entrepreneurial Risk*

As described in the Background section of this preamble, Congress indicated that the most important factor in determining whether or not an arrangement constitutes a payment for services is that the allocation and distribution is subject to significant entrepreneurial risk. S. Prt. at 227. Congress noted that partners extract the profits of the partnership based on the business success of the venture, while third parties generally receive payments that are not subject to this risk. *Id.*

The proposed regulations reflect Congress's view that this factor is most important. Under the proposed regulations, an arrangement that lacks significant entrepreneurial risk constitutes a disguised payment for services. An arrangement in which allocations and distributions to the service provider are subject to significant entrepreneurial risk will generally be recognized as a distributive share but the ultimate determination depends on the totality of the facts and circumstances. The Treasury Department and the IRS request comments on whether allocations to service providers that lack significant entrepreneurial risk could be characterized as distributive shares under section 704(b) in any circumstances.

Whether an arrangement lacks significant entrepreneurial risk is based on the service provider's entrepreneurial risk relative to the overall entrepreneurial risk of the partnership. For example, a service provider who receives a percentage of net profits in each of a partnership that invests in high-quality debt instruments and a partnership that invests in volatile or unproven businesses may have significant entrepreneurial risk with respect to both interests.

Section 1.707–2(c)(1)(i) through (v) of the proposed regulations set forth arrangements that presumptively lack significant entrepreneurial risk. These arrangements are presumed to result in an absence of significant entrepreneurial risk (and therefore, a disguised payment for services) unless other facts and circumstances can establish the presence of significant entrepreneurial risk by clear and convincing evidence. These examples generally describe facts and circumstances in which there is a high likelihood that the service provider will receive an allocation regardless of the overall success of the business operation, including (i) capped allocations of partnership income if the cap would reasonably be expected to apply in most years, (ii) allocations for a fixed number of years under which the service provider's distributive share of income is reasonably certain, (iii) allocations of gross income items, (iv) an allocation (under a formula or otherwise) that is predominantly fixed in amount, is reasonably determinable under all the facts and circumstances, or is designed to assure that sufficient net profits are highly likely to be available to make the allocation to the service provider (for example, if the partnership agreement provides for an allocation of net profits from specific transactions or accounting periods and this allocation does not depend on the overall success of the enterprise), and (v) arrangements in which a service provider either waives its right to receive payment for the future performance of services in a manner that is non-binding or fails to timely notify the partnership and its partners of the waiver and its terms.

With respect to the fourth example, the presence of certain facts, when coupled with a priority allocation to the service provider that is measured over any accounting period of the partnership of 12 months or less, may create opportunities that will lead to a higher likelihood that sufficient net profits will be available to make the allocation. One fact is that the value of partnership assets is not easily ascertainable and the partnership agreement allows the service provider or a related party in connection with a revaluation to control the determination of asset values, including by controlling events that may affect those values (such as timing of announcements that affect the value of the assets). (See Example 3(iv).) Another fact is that the service provider or a related party controls the entities in which the partnership invests, including controlling the timing and amount of distributions by those controlled entities. (These two facts by themselves do not, however, necessarily establish the absence of significant entrepreneurial risk.) By contrast, certain priority allocations that are intended to equalize a service provider's return with priority allocations already allocated to investing partners over the life of the partnership (commonly known as "catch-up allocations") typically will not fall within the types of allocations covered by the fourth example and will not lack significant entrepreneurial risk, although all of the facts and circumstances are considered in making that determination.

With respect to the fifth example, the Treasury Department and the IRS request suggestions regarding fee waiver requirements that sufficiently bind the waiving service provider and that are administrable by the partnership and its partners.

Congress's emphasis on entrepreneurial risk requires changes to existing regulations under section 707(c). Specifically, Example 2 of § 1.707–1(c) provides that if a partner is entitled to an allocation of the greater of 30 percent of partnership income or a minimum guaranteed amount, and the income allocation exceeds the minimum guaranteed amount, then the entire income allocation is treated as a distributive share under section 704(b). Example 2 also provides that if the income allocation is less than the guaranteed amount, then the partner is treated as receiving a distributive share to the extent of the income allocation and a guaranteed payment to the extent that the minimum guaranteed payment exceeds the income allocation. The treatment of the arrangements in Example 2 is inconsistent with the concept that an allocation must be subject to significant entrepreneurial risk to be treated as a distributive share under section 704(b). Accordingly, the proposed regulations modify Example 2 to provide that the entire minimum amount is treated as a guaranteed payment under section 707(c) regardless of the amount of the income allocation. Rev. Rul. 66–95, 1966–1 C.B. 169, and Rev. Rul. 69–180, 1969–1 C.B. 183, are also inconsistent with these proposed regulations. The Treasury Department and the IRS intend to obsolete Rev. Rul. 66–95 and Rev. Rul. 69–180, when these regulations are published in final form.

B. *Secondary factors*

Section 1.707–2(c)(2) through (6) describes additional factors of secondary importance in determining whether or not an arrangement that gives the appearance of significant entrepreneurial risk constitutes a payment for services. The weight given to each of the other factors depends on the particular case, and the absence of a particular factor is not necessarily determinative of whether an arrangement is treated as a payment for services. Four of these factors, described by Congress in the legislative history to section 707(a)(2)(A), are (i) that the service provider holds, or is expected to hold, a transitory partnership interest or a partnership interest for only a short duration, (ii) that the service provider receives an allocation and distribution in a time frame comparable to the time frame that a non-partner service provider would typically receive payment, (iii) that the service provider became a partner primarily to obtain tax benefits which would not have been available if the services were rendered to the partnership in a third party capacity, and (iv) that the value of the service provider's interest in general and continuing partnership profits is small in relation to the allocation and distribution.

To these four factors, the proposed regulations add a fifth factor. The fifth factor is present if the arrangement provides for different allocations or distributions with respect to different services received, where the services are provided either by a single person or by persons that are related under sections 707(b) or 267(b), and the terms of the differing allocations or distributions are subject to levels of entrepreneurial risk that vary significantly. For example, assume that a partnership receives services from both its general partner and from a management company that is related to the general partner under section 707(b). Both the general partner and the management company receive a share in future partnership net profits in exchange for their services. The general partner is entitled to an allocation of 20 percent of net profits and undertakes an enforceable obligation to repay any amounts distributed pursuant to its interest (reduced by reasonable allowance for tax payments made on the general partner's allocable shares of partnership income and gain) that exceed 20 percent of the overall net amount of partnership profits computed over the partnership's life and it is reasonable to anticipate that the general partner can and will comply fully with this obligation. The proposed regulations refer to this type of obligation and similar obligations, as a "clawback obligation." In contrast, the management company is entitled to a preferred amount of net income that, once paid, is not subject to a clawback obligation. Because the general partner and the management company are service providers that are related parties under section 707(b), and because the terms of the allocations and distributions to the management company create a significantly lower level of economic risk than the terms for the general partner, the management company's arrangement might properly be treated as a disguised payment for services (depending on all other facts and circumstances, including amount of entrepreneurial risk).

III. *Examples*

Section 1.707–2(d) of the proposed regulations contains a number of examples illustrating the application of the factors described in § 1.707–2(c). The examples illustrate the application of these regulations to arrangements that contain certain facts and circumstances that the Treasury Department and the IRS believe demonstrate the existence or absence of significant entrepreneurial risk.

Several of the examples consider arrangements in which a partner agrees to forgo fees for services and also receives a share of future partnership income and gains. The examples consider the application of section 707(a)(2)(A) based on the manner in which the service provider (i) forgoes its right to receive fees, and (ii) is entitled to share in future partnership income and gains. In Examples 5 and 6, the service provider forgoes the right to receive fees in a manner that supports the existence of significant entrepreneurial risk by forgoing its right to receive fees before the period begins and by executing a waiver that is binding, irrevocable, and clearly communicated to the other partners. Similarly, the service provider's arrangement in these examples include the following facts and circumstances that taken together support the existence of significant entrepreneurial risk: the allocation to the service provider is determined out of net profits and is neither highly likely to be available nor reasonably determinable based on all facts and circumstances available at the time of the arrangement, and the service provider undertakes a clawback obligation and is reasonably expected to be able to comply with that obligation. The presence of each fact described in these examples is not necessarily required to determine that section 707(a)(2)(A) does not apply to an arrangement. However, the absence of certain facts, such as a failure to measure future profits over at least a 12-month period, may suggest that an arrangement constitutes a fee for services.

The proposed regulations also contain examples that consider arrangements to which section 707(a)(2)(A) applies. Example 1 concludes that an arrangement in which a service provider receives a capped amount of partnership allocations and distributions and the cap is likely to apply provides for a disguised payment for services under section 707(a)(2)(A). In Example 3(iii), a service provider is entitled to a share of future partnership net profits, the partnership can allocate net profits from specific transactions or accounting periods, those allocations do not depend on the long-term future success of the enterprise, and a party that is related to the service provider controls the timing of purchases, sales, and distributions. The example concludes that under these facts, the arrangement lacks significant entrepreneurial risk and provides for a disguised payment for services. Example 4 considers similar facts, but assumes that the partnership's assets are publicly traded and are marked-to-market under section 475(f)(1). Under these facts, the example concludes that the arrangement has significant entrepreneurial risk, and thus that section 707(a)(2)(A) does not apply.

IV. *Safe Harbor Revenue Procedures*

Rev. Proc. 93–27 provides that in certain circumstances if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of becoming a partner, the IRS will not treat the receipt of such interest as a taxable event for the partner or the partnership. The revenue procedure does not apply if (1) the profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease; (2) within two years of receipt, the partner disposes of the profits interest; or (3) the profits interest is a limited partnership interest in a "publicly traded partnership" within the meaning of section 7704(b).

Rev. Proc. 2001–43 provides that, for purposes of Rev. Proc. 93–27, if a partnership grants a substantially nonvested profits interest in the partnership to a service provider, the service provider will be treated as receiving the interest on the date of its grant, provided that: (i) the partnership and the service provider treat the service provider as the owner of the partnership interest from the date of its grant, and the service provider takes into account the distributive share of partnership income, gain, loss, deduction and credit associated with that interest in computing the service provider's income tax liability for the entire period during which the service provider has the interest; (ii) upon the grant of the interest or at the time that the interest becomes substantially vested, neither the partnership nor any of the partners deducts any amount (as wages, compensation, or otherwise) for the fair market value of the interest; and (iii) all other conditions of Rev. Proc. 93–27 are satisfied.

The Treasury Department and the IRS are aware of transactions in which one party provides services and another party receives a seemingly associated allocation and distribution of partnership income or gain. For example, a management company that provides services to a fund in exchange for a fee may waive that fee, while a party related to the management company receives an interest in future partnership profits the value of which approximates the amount of the waived fee. The Treasury Department and the IRS have determined that Rev. Proc. 93–27 does not apply to such transactions because they would not satisfy the requirement that receipt of an interest in partnership profits be for the provision of services to or for the benefit of the partnership in a partner capacity or in anticipation of being a partner, and because the service provider would effectively have disposed of the partnership interest (through a constructive transfer to the related party) within two years of receipt.

Further, the Treasury Department and the IRS plan to issue a revenue procedure providing an additional exception to the safe harbor in Rev. Proc. 93–27 in conjunction with the publication of these regulations in final form. The additional exception will apply to a profits interest issued in conjunction with a partner forgoing payment of an amount that is substantially fixed (including a substantially fixed amount determined by formula, such as a fee based on a percentage of partner capital commitments) for the performance of services, including a guaranteed payment under section 707(c) or a payment in a non-partner capacity under section 707(a).

In conjunction with the issuance of proposed regulations (REG–105346–03; 70 FR 29675–01; 2005–1 C.B. 1244) relating to the tax treatment of certain transfers of partnership equity in connection with the performance of services, the Treasury Department and the IRS issued Notice 2005–43, 2005–24 I.R.B. 1221. Notice 2005–43 includes a proposed revenue procedure regarding partnership interests transferred in connection with the performance of services. In the event that the proposed revenue procedure provided for in Notice 2005–43 is finalized, it will include the additional exception referenced.

Effective Dates

The proposed regulations would be effective on the date the final regulations are published in the **Federal Register** and would apply to any arrangement entered into or modified on or after the date of publication of the final regulations. In the case of any arrangement entered into or modified before the final regulations are published in the **Federal Register**, the determination of whether an arrangement is a disguised payment for services under section 707(a)(2)(A) is made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 707(a)(2)(A). Pending the publication of final regulations, the position of the Treasury Department and the IRS is that the proposed regulations generally reflect Congressional intent as to which arrangements are appropriately treated as disguised payments for services.

Effect on Other Documents

The following publication is obsolete as of July 23, 2015:

Rev. Rul. 81–300 (1981–2 C.B. 143).

The following publications will be obsolete as of the date of a Treasury Decision adopting these rules as final regulations in the **Federal Register**:

Rev. Rul. 66–95 (1966–1 C.B. 169); and

Rev. Rul. 69–180 (1969–1 C.B. 183).

Special Analyses

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 section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, 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. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

The Treasury Department and the IRS invite public comment on these proposed regulations. The legislative history supporting section 707(a)(2)(A) indicates that an arrangement that lacks significant entrepreneurial risk is generally treated as a disguised payment for services. The Treasury Department and the IRS have concluded that the presence of significant entrepreneurial risk in an arrangement is necessary for the arrangement to be treated as occurring between a partnership and a partner acting in a partner capacity. Nonetheless, the Treasury Department and the IRS request comments on, and examples of, whether arrangements could exist that should be treated as a distributive share under section 704(b) despite the absence of significant entrepreneurial risk. In addition, the Treasury Department and the IRS request comments on sufficient notification requirements to effectively render a fee waiver binding upon the service provider and the partnership.

The Treasury Department and the IRS have become aware that some partnerships that assert reliance on § 1.704–1(b)(2)(ii)(i) (the economic effect equivalence rule) have expressed uncertainty on the proper treatment of partners who receive an increased right to share in partnership property upon a partnership liquidation without respect to the partnership's net income. These partnerships typically set forth each partner's distribution rights upon a liquidation of the partnership and require the partnership to allocate net income annually in a manner that causes partners' capital accounts to match partnership distribution rights to the extent possible. Such agreements are commonly referred to as "targeted capital account agreements." Some taxpayers have expressed uncertainty whether a partnership with a targeted capital account agreement must allocate income or a guaranteed payment to a partner who has an increased right to partnership assets determined as if the partnership liquidated at the end of the year even in the event that the partnership recognizes no, or insufficient, net income. The Treasury Department and the IRS generally believe that existing rules under §§ 1.704–1(b)(2)(ii) and 1.707–1(c) address this circumstance by requiring partner capital accounts to reflect the partner's distribution rights as if the partnership liquidated at the end of the taxable year, but request comments on specific issues and examples with respect to which further guidance would be helpful. No inference is intended as to whether and when targeted capital account agreements could satisfy the economic effect equivalence rule.

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 Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments will be available for public inspection and copying upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic 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 Jaclyn M. Goldberg of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Internal Revenue Service and the Treasury Department participated in their development.

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Proposed Amendment to the Regulations

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

PART 1— INCOME TAXES

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

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

Section 1.707–0 also issued under 26 U.S.C. 707(a).

Section 1.707–2 also issued under 26 U.S.C. 707(a).

Section 1.707–9 also issued under 26 U.S.C. 707(a). * * *

Section 1.736–1 also issued under 26 U.S.C. 736(a). * * *

Par. 2. Section 1.707–0 is amended by revising § 1.707–2 to read as follows:

§ 1.707–0. Table of contents.

* * * * *

§ 1.707–2. Disguised payments for services.

(a) In general.

(b) Elements necessary to characterize arrangements as disguised payments for services.

(1) In general.

(2) Application and timing.

(i) Timing and effect of the determination.

(ii) Timing of inclusion.

(3) Application of disguised payment rules.

(c) Factors considered.

(d) Examples.

* * * * *

Par. 3. Section 1.707–1 is amended by adding a sentence at the end of paragraph (a) and revising paragraph (c) Example 2 to read as follows:

§ 1.707–1. Transactions between partner and partnership.

(a) * * * For arrangements pursuant to which a purported partner performs services for a partnership and the partner receives a related direct or indirect allocation and distribution from the partnership, see § 1.707–2 to determine whether the arrangement should be treated as a disguised payment for services.

(c) * * *

Example 2. Partner C in the CD partnership is to receive 30 percent of partnership income, but not less than $10,000. The income of the partnership is $60,000, and C is entitled to $18,000 (30 percent of $60,000). Of this amount, $10,000 is a guaranteed payment to C. The $10,000 guaranteed payment reduces the partnership's net income to $50,000 of which C receives $8,000 as C's distributive share.

* * * * *

Par. 4. Section 1.707–2 is added to read as follows:

§ 1.707–2. Disguised payments for services.

(a) *In general*. This section prescribes rules for characterizing arrangements as disguised payments for services. Paragraph (b) of this section outlines the elements necessary to characterize an arrangement as a payment for services, and it provides operational rules regarding application and timing of this section. Paragraph (c) of this section identifies the factors that weigh in the determination of whether an arrangement includes the elements described in paragraph (b) of this section that make it appropriate to characterize the arrangement as a payment for services. Paragraph (d) of this section provides examples applying these rules to determine whether an arrangement is a payment for services.

(b) *Elements necessary to characterize arrangements as disguised payments for services*—(1) *In general*. An arrangement will be treated as a disguised payment for services if—

(i) A person (service provider), either in a partner capacity or in anticipation of becoming a partner, performs services (directly or through its delegate) to or for the benefit of a partnership;

(ii) There is a related direct or indirect allocation and distribution to such service provider; and

(iii) The performance of such services and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a person acting other than in that person's capacity as a partner.

(2) *Application and timing*.—(i) *Timing and effect of the determination*. Whether an arrangement is properly characterized as a payment for services is determined at the time the arrangement is entered into or modified and without regard to whether the terms of the arrangement require the allocation and distribution to occur in the same taxable year. An arrangement that is treated as a payment for services under this paragraph (b) is treated as a payment for services for all purposes of the Internal Revenue Code, including for example, sections 61, 409A, and 457A (as applicable). The amount paid to a person in consideration for services under this section is treated as a payment for services provided to the partnership, and, when appropriate, the partnership must capitalize these amounts (or otherwise treat such amounts in a manner consistent with their recharacterization). The partnership must also treat the arrangement as a payment to a non-partner in determining the remaining partners' shares of taxable income or loss.

(ii) *Timing of inclusion*. The inclusion of income by the service provider and deduction (if applicable) by the partnership of amounts paid pursuant to an arrangement that is characterized as a payment for services under paragraph (b)(1) of this section is taken into account in the taxable year as required under applicable law by applying all relevant sections of the Internal Revenue Code, including for example, sections 409A and 457A (as applicable), to the allocation and distribution when they occur (or are deemed to occur under all other provisions of the Internal Revenue Code).

(3) *Application of disguised payment rules*. If a person purports to provide ser-

vices to a partnership in a capacity as a partner or in anticipation of becoming a partner, the rules of this section apply for purposes of determining whether the services were provided in exchange for a disguised payment, even if it is determined after applying the rules of this section that the service provider is not a partner. If after applying the rules of this section, no partnership exists as a result of the service provider failing to become a partner under the arrangement, then the service provider is treated as having provided services directly to the other purported partner.

(c) *Factors considered*. Whether an arrangement constitutes a payment for services (in whole or in part) depends on all of the facts and circumstances. Paragraphs (c)(1) through (6) of this section provide a non-exclusive list of factors that may indicate that an arrangement constitutes (in whole or in part) a payment for services. The presence or absence of a factor is based on all of the facts and circumstances at the time the parties enter into the arrangement (or if the parties modify the arrangement, at the time of the modification). The most important factor is significant entrepreneurial risk as set forth in paragraph (c)(1) of this section. An arrangement that lacks significant entrepreneurial risk constitutes a payment for services. An arrangement that has significant entrepreneurial risk will generally not constitute a payment for services unless other factors establish otherwise. For purposes of making determinations under this paragraph (c), the weight to be given to any particular factor, other than entrepreneurial risk, depends on the particular case and the absence of a factor is not necessarily indicative of whether or not an arrangement is treated as a payment for services.

(1) The arrangement lacks significant entrepreneurial risk. Whether an arrangement lacks significant entrepreneurial risk is based on the service provider's entrepreneurial risk relative to the overall entrepreneurial risk of the partnership. Paragraphs (c)(1)(i) through (v) of this section provide facts and circumstances that create a presumption that an arrangement lacks significant entrepreneurial risk and will be treated as a disguised payment for services unless other facts and circumstances establish the presence of significant entrepreneurial risk by clear and convincing evidence:

(i) Capped allocations of partnership income if the cap is reasonably expected to apply in most years;

(ii) An allocation for one or more years under which the service provider's share of income is reasonably certain;

(iii) An allocation of gross income;

(iv) An allocation (under a formula or otherwise) that is predominantly fixed in amount, is reasonably determinable under all the facts and circumstances, or is designed to assure that sufficient net profits are highly likely to be available to make the allocation to the service provider (e.g. if the partnership agreement provides for an allocation of net profits from specific transactions or accounting periods and this allocation does not depend on the long-term future success of the enterprise); or

(v) An arrangement in which a service provider waives its right to receive payment for the future performance of services in a manner that is non-binding or fails to timely notify the partnership and its partners of the waiver and its terms.

(2) The service provider holds, or is expected to hold, a transitory partnership interest or a partnership interest for only a short duration.

(3) The service provider receives an allocation and distribution in a time frame comparable to the time frame that a non-partner service provider would typically receive payment.

(4) The service provider became a partner primarily to obtain tax benefits that would not have been available if the services were rendered to the partnership in a third party capacity.

(5) The value of the service provider's interest in general and continuing partnership profits is small in relation to the allocation and distribution.

(6) The arrangement provides for different allocations or distributions with respect to different services received, the services are provided either by one person or by persons that are related under sections 707(b) or 267(b), and the terms of the differing allocations or distributions are subject to levels of entrepreneurial risk that vary significantly.

(d) *Examples*. The following examples illustrate the application of this section:

Example 1. Partnership ABC constructed a building that is projected to generate $100,000 of gross income annually. A, an architect, performs services for partnership ABC for which A's normal fee would be $40,000 and contributes cash in an amount equal to the value of a 25 percent interest in the partnership. In exchange, A will receive a 25 percent distributive share for the life of the partnership and a special allocation of $20,000 of partnership gross income for the first two years of the partnership's operations. The ABC partnership agreement satisfies the requirements for economic effect contained in § 1.704–1(b)(2)(ii), including requiring that liquidating distributions are made in accordance with the partners' positive capital account balances. Under paragraph (c) of this section, whether the arrangement is treated as a payment for services depends on the facts and circumstances. The special allocation to A is a capped amount and the cap is reasonably expected to apply. The special allocation is also made out of gross income. Under paragraphs (c)(1)(i) and (iii) of this section, the capped allocations of income and gross income allocations described are presumed to lack significant entrepreneurial risk. No additional facts and circumstances establish otherwise by clear and convincing evidence. Thus, the allocation lacks significant entrepreneurial risk. Accordingly, the arrangement provides for a disguised payment for services as of the date that A and ABC enter into the arrangement and, pursuant to paragraph (b)(2)(ii) of this section, should be included in income by A in the time and manner required under applicable law as determined by applying all relevant sections of the Internal Revenue Code to the arrangement.

Example 2. A, a stock broker, agrees to effect trades for Partnership ABC without the normal brokerage commission. A contributes 51 percent of partnership capital and in exchange, receives a 51 percent interest in residual partnership profits and losses. In addition, A receives a special allocation of gross income that is computed in a manner which approximates its foregone commissions. The special allocation to A is computed by means of a formula similar to a normal brokerage fee and varies with the value and amount of services rendered rather than with the income of the partnership. It is reasonably expected that Partnership ABC will have sufficient gross income to make this allocation. The ABC partnership agreement satisfies the requirements for economic effect contained in § 1.704–1(b)(2)(ii), including requiring that liquidating distributions are made in accordance with the partners' positive capital account balances. Under paragraph (c) of this section, whether the arrangement is treated as a payment for services depends on the facts and circumstances. Under paragraphs (c)(1)(iii) and (iv) of this section, because the allocation is an allocation of gross income and is reasonably determinable under the facts and circumstances, it is presumed to lack significant entrepreneurial risk. No additional facts and circumstances establish otherwise by clear and convincing evidence. Thus, the allocation lacks significant entrepreneurial risk. Accordingly, the arrangement provides for a disguised payment for services as of the date that A and ABC enter into the arrangement and, pursuant to paragraph (b)(2)(ii) of this section, should be included in income by A in the time and manner required under applicable law as determined by applying all relevant sections of the Internal Revenue Code to the arrangement.

Example 3. (i) M performs services for which a fee would normally be charged to new partnership ABC, an investment partnership that will acquire a portfolio of investment assets that are not readily tradable on an established securities market. M will also contribute $500,000 in exchange for a one percent interest in ABC's capital and profits. In addition to M's one percent interest, M is entitled to receive a priority allocation and distribution of net gain from the sale of any one or more assets during any 12-month accounting period in which the partnership has overall net gain in an amount intended to approximate the fee that would normally be charged for the services M performs. A, a company that controls M, is the general partner of ABC and directs all operations of the partnership consistent with the partnership agreement, including causing ABC to purchase or sell an asset during any accounting period. A also controls the timing of distributions to M including distributions arising from M's priority allocation. Given the nature of the assets in which ABC will invest and A's ability to control the timing of asset dispositions, the amount of partnership net income or gains that will be allocable to M under the ABC partnership agreement is highly likely to be available and reasonably determinable based on all facts and circumstances available upon formation of the partnership. A will be allocated 10 percent of any net profits or net losses of ABC earned over the life of the partnership. A undertakes an enforceable obligation to repay any amounts allocated and distributed pursuant to this interest (reduced by reasonable allowances for tax payments made on A's allocable shares of partnership income and gain) that exceed 10 percent of the overall net amount of partnership profits computed over the life of the partnership (a "clawback obligation"). It is reasonable to anticipate that A could and would comply fully with any repayment responsibilities that arise pursuant to this obligation. The ABC partnership agreement satisfies the requirements for economic effect contained in § 1.704–1(b)(2)(ii), including requiring that liquidating distributions are made in accordance with the partners' positive capital account balances.

(ii) Under paragraph (c) of this section, whether A's arrangement is treated as a payment for services in directing ABC's operations depends on the facts and circumstances. The most important factor in this facts and circumstances determination is the presence or absence of significant entrepreneurial risk. The arrangement with respect to A creates significant entrepreneurial risk under paragraph (c)(1) of this section because the allocation to A is of net profits earned over the life of the partnership, the allocation is subject to a clawback obligation and it is reasonable to anticipate that A could and would comply with this obligation, and the allocation is neither reasonably determinable nor highly likely to be available. Additionally, other relevant factors do not establish that the arrangement should be treated as a payment for services. Thus, the arrangement with respect to A does not constitute a payment for services for purposes of paragraph (b)(1) of this section.

(iii) Under paragraph (c) of this section, whether M's arrangement is treated as a payment for services depends on the facts and circumstances. The most important factor in this facts and circumstances determination is the presence or absence of entrepreneurial risk. The priority allocation to M is an allocation of net profit from any 12-month accounting period in which the partnership has net gain, and thus it does not depend on the overall success of the enterprise. Moreover, the sale of the assets by ABC, and hence the timing of recognition of gains and losses, is controlled by A, a company related to M. Taken in combination, the facts indicate that the allocation is reasonably determinable under all the facts and circumstances and that sufficient net profits are highly likely to be available to make the priority allocation to the service provider. As a result, the allocation presumptively lacks significant entrepreneurial risk. No additional facts and circumstances establish otherwise by clear and convincing evidence. Accordingly, the arrangement provides for a disguised payment for services as of the date M and ABC enter into the arrangement and, pursuant to paragraph (b)(2)(ii) of this section, should be included in income by M in the time and manner required under applicable law as determined by applying all relevant sections of the Internal Revenue Code to the arrangement.

(iv) Assume the facts are the same as paragraph (i) of this example, except that the partnership can also fund M's priority allocation and distribution of net gain from the revaluation of any partnership assets pursuant to § 1.704–1(b)(2)(iv)(f). As the general partner of ABC, A controls the timing of events that permit revaluation of partnership assets and assigns values to those assets for purposes of the revaluation. Under paragraph (c) of this section, whether M's arrangement is treated as a payment for services depends on the facts and circumstances. The most important factor in this facts and circumstances determination is the presence or absence of significant entrepreneurial risk. Under this arrangement, the valuation of the assets is controlled by A, a company related to M, and the assets of the company are difficult to value. This fact, taken in combination with the partnership's determination of M's profits by reference to a specified accounting period, causes the allocation to be reasonably determinable under all the facts and circumstances or to ensure that net profits are highly likely to be available to make the priority allocation to the service provider. No additional facts and circumstances establish otherwise by clear and convincing evidence. Accordingly, the arrangement provides for a disguised payment for services as of the date M and ABC enter into the arrangement and, pursuant to paragraph (b)(2)(ii) of this section, should be included in income by M in time and manner required under applicable law as determined by applying all relevant sections of the Internal Revenue Code to the arrangement.

Example 4. (i) The facts are the same as in *Example 3*, except that ABC's investment assets are securities that are readily tradable on an established securities market, and ABC is in the trade or business of trading in securities and has validly elected to mark-to-market under section 475(f)(1). In addition, M is entitled to receive a special allocation and distribution of partnership net gain attributable to a specified future 12-month taxable year. Although it is expected that one or more of the partnership's assets will be sold for a gain, it cannot reasonably be predicted whether the partnership will have net profits with respect to its entire portfolio in that 12-month taxable year.

(ii) Under paragraph (c) of this section, whether the arrangement is treated as a payment for services depends on the facts and circumstances. The most important factor in this facts and circumstances determination is the presence or absence of significant entrepreneurial risk. The special allocation to M is allocable out of net profits, the partnership assets have a readily ascertainable market value that is determined at the close of each taxable year, and it cannot reasonably be predicted whether the partnership will have net profits with respect to its entire portfolio for the year to which the special allocation would relate. Accordingly, the special allocation is neither reasonably determinable nor highly likely to be available because the partnership assets have a readily ascertainable fair market value that is determined at the beginning of the year and at the end of the year. Thus, the arrangement does not lack significant entrepreneurial risk under paragraph (c)(1) of this section. Additionally, the facts and circumstances do not establish the presence of other factors that would suggest that the arrangement is properly characterized as a payment for services. Accordingly, the arrangement does not constitute a payment for services under paragraph (b)(1) of this section.

Example 5. (i) A is a general partner in newly-formed partnership ABC, an investment fund. A is responsible for providing management services to ABC, but has delegated that management function to M, a company controlled by A. Funds that are comparable to ABC commonly require the general partner to contribute capital in an amount equal to one percent of the capital contributed by the limited partners, provide the general partner with an interest in 20 percent of future partnership net income and gains as measured over the life of the fund, and pay the fund manager annually an amount equal to two percent of capital committed by the partners.

(ii) Upon formation of ABC, the partners of ABC execute a partnership agreement with terms that differ from those commonly agreed upon by other comparable funds. The ABC partnership agreement provides that A will contribute nominal capital to ABC, that ABC will annually pay M an amount equal to one percent of capital committed by the partners, and that A will receive an interest in 20 percent of future partnership net income and gains as measured over the life of the fund. A will also receive an additional interest in future partnership net income and gains determined by a formula (the "Additional Interest"). The parties intend that the estimated present value of the Additional Interest approximately equals the present value of one percent of capital committed by the partners determined annually over the life of the fund. However, the amount of net profits that will be allocable to A under the Additional Interest is neither highly likely to be available nor reasonably determinable based on all facts and circumstances available upon formation of the partnership. A undertakes a clawback obligation, and it is reasonable to anticipate that A could and would comply fully with any repayment responsibilities that arise pursuant to this obligation. The ABC partnership agreement satisfies the requirements for economic effect contained in § 1.704–1(b)(2)(ii), including requiring that liquidating distributions are made in accordance with the partners' positive capital account balances.

(iii) Under paragraph (c) of this section, whether the arrangement relating to the Additional Interest is treated as a payment for services depends on the facts and circumstances. The most important factor in this facts and circumstances determination is the presence or absence of significant entrepreneurial risk. The arrangement with respect to A creates significant entrepreneurial risk under paragraph (c)(1) of this section because the allocation to A is of net profits, the allocation is subject to a clawback obligation over the life of the fund and it is reasonable to anticipate that A could and would comply with this obligation, and the allocation is neither reasonably determinable nor highly likely to be available. Additionally, the facts and circumstances do not establish the presence of other factors that would suggest that the arrangement is properly characterized as a payment for services. Accordingly, the arrangement does not constitute a payment for services under paragraph (b)(1) of this section.

Example 6. (i) A is a general partner in limited partnership ABC, an investment fund. A is responsible for providing management services to ABC, but has delegated that management function to M, a company controlled by A. The ABC partnership agreement provides that A must contribute capital in an amount equal to one percent of the capital contributed by the limited partners, that A is entitled to an interest in 20 percent of future partnership net income and gains as measured over the life of the fund, and that M is entitled to receive an annual fee in an amount equal to two percent of capital committed by the partners. The amount of partnership net income or gains that will be allocable to A under the ABC partnership agreement is neither highly likely to be available nor reasonably determinable based on all facts and circumstances available upon formation of the partnership. A also undertakes a clawback obligation, and it is reasonable to anticipate that A could and would comply fully with any repayment responsibilities that arise pursuant to this obligation.

(ii) ABC's partnership agreement also permits M (as A's appointed delegate) to waive all or a portion of its fee for any year if it provides written notice to the limited partners of ABC at least 60 days prior to the commencement of the partnership taxable year for which the fee is payable. If M elects to waive irrevocably its fee pursuant to this provision, the partnership will, immediately following the commencement of the partnership taxable year for which the fee would have been payable, issue to M an interest determined by a formula in subsequent partnership net income and gains (the "Additional Interest"). The parties intend that the estimated present value of the Additional Interest approximately equals the estimated present value of the fee that was waived. However, the amount of net income or gains that will be allocable to M is neither highly likely to be available nor reasonably determinable based on all facts and circumstances available at the time of the waiver of the fee. The ABC partnership agreement satisfies the requirements for economic effect contained in § 1.704–1(b)(2)(ii), including requiring that liquidating distributions are made in accordance with the partners' positive capital account balances. The partnership agreement also requires ABC to maintain capital accounts pursuant to § 1.704–1(b)(2)(iv) and to revalue partner capital accounts under § 1.704–1(b)(2)(iv)(f) immediately prior to the issuance of the partnership interest to M. M undertakes a clawback obligation, and it is reasonable to anticipate that M could and would comply fully with any repayment responsibilities that arise pursuant to this obligation.

(iii) Under paragraph (c) of this section, whether the arrangements relating to A's 20 percent interest in future partnership net income and gains and M's Additional Interest are treated as payment for services depends on the facts and circumstances. The most important factor in this facts and circumstances determination is the presence or absence of significant entrepreneurial risk. The allocations to A and M do not presumptively lack significant entrepreneurial risk under paragraph (c)(1) of this section because the allocations are based on net profits, the allocations are subject to a clawback obligation over the life of the fund and it is reasonable to anticipate that A and M could and would comply with this obligation, and the allocations are neither reasonably determinable nor highly likely to be available. Additionally, the facts and circumstances do not establish the presence of other factors that would suggest that the arrangement is properly characterized as a payment for services. Accordingly, the arrangements do not constitute payment for services under paragraph (b)(1) of this section.

Par. 5. Section 1.707–9 is amended by:

a. Redesignating paragraph (b) as paragraph (c);

b. Redesignating paragraph (a) as paragraph (b); and

c. Adding new paragraph (a).

The addition reads as follows:

§ 1.707–9. Effective dates and transitional rules.

(a) *Section 1.707–2*—(1) *In general*. Section 1.707–2 applies to all arrangements entered into or modified after the date of publication of the Treasury Decision adopting that section as final regulations in the **Federal Register**. To the extent that an arrangement permits a service provider to waive all or a portion of its fee for any period subsequent to the date the arrangement is created, then the arrangement is modified for purposes of this paragraph on the date or dates that the fee is waived.

(2) *Arrangements entered into or modified before final regulations are published* in the ***Federal Register***. In the case of any arrangement entered into or modified that occurs on or before final regulations are published in the **Federal Register**, the determination of whether the arrangement is a disguised fee for services under section 707(a)(2)(A) is to be made on the basis of the statute and the guidance provided regarding that provision in the legislative history of section 73 of the Tax Reform Act of 1984 (Pub. L. 98–369, 98 Stat. 494). See H.R. Rep. No. 861, 98th Cong., 2d Sess. 859–2 (1984); S. Prt. No. 169 (Vol. I), 98th Cong., 2d Sess. 223–32 (1984); H.R. Rep. No. 432 (Pt. 2), 98th Cong., 2d Sess. 1216–21 (1984).

* * * * *

Par. 6. Section 1.736–1 is amended by adding a sentence at the end of paragraph (a)(1)(i) to read as follows:

§ 1.736–1. Payments to a retiring partner or a deceased partner's successor in interest.

(a) * * *

(1)(i) * * * Section 736 does not apply to arrangements treated as disguised payments for services under § 1.707–2.

* * * * *

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 22, 2015, 8:45 a.m., and published in the issue of the Federal Register for July 23, 2015, 80 F.R. 43652)

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 2015–27 through 2015–32

Announcements:

Notices:

Proposed Regulations:

Revenue Procedures:

Revenue Rulings:

Treasury Decisions:

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

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

Bulletins 2015–27 through 2015–32

Notices:

2014-4
Modified by
Notice 2015-51, 2015-31 I.R.B. *133*

Revenue Procedures:

2011-49
Modified by
Rev. Proc. 2015-36, 2015-27 I.R.B. *20*

2011-49
Superseded by
Rev. Proc. 2015-36, 2015-27 I.R.B. *20*

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

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