INTERNAL REVENUE BULLETIN

IRS

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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

Notice 2018–07, page 317.

This notice provides preliminary guidance for determining amounts included in gross income by a United States shareholder under section 951(a)(1) by reason of section 965 of the Internal Revenue Code as amended by "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018", P.L. 115–97, which was enacted on December 22, 2017.

REG–119514–15, page 324.

This document contains proposed regulations that provide guidance on the treatment of foreign currency gain or loss of a controlled foreign corporation (CFC) under the business needs exclusion from foreign personal holding company income. The proposed regulations also provide an election for a taxpayer to use a mark-to-market method of accounting for foreign currency gain or loss attributable to section 988 transactions. In addition, the proposed regulations permit the controlling United States shareholders of a CFC to automatically revoke certain elections concerning the treatment of foreign currency gain or loss. The proposed regulations affect taxpayers and United States shareholders of CFCs that engage in transactions giving rise to foreign currency gain or loss under section 988 of the Internal Revenue Code.

Employee Plans

Rev. Rul. 2018–04, page 304.

This revenue ruling provides tables of covered compensation under § 401(l)(5)(E) of the Internal Revenue Code and the Income Tax Regulations thereunder, effective January 1, 2018. These tables of covered compensation reflect a revision to the taxable wage base for 2018 that was announced by the Social Security Administration on November 27, 2017, and apply in lieu of the tables that were provided in Revenue Ruling 2017–22, 2017–48 I.R.B. 536, 2017.

Administrative

T.D 9829, page 307.

Under section the Bipartisan Budget Act of 2015, Public Law 114–74 (BBA), each partnership required to file a partnership return is subject to the new rules, but certain partnerships may choose to elect out under section 6221(b) if they are eligible. These regulations provide the time, form, and manner for making any election under section 6221(b) as well as providing guidance regarding eligibility to make the election. The regulations affect partnerships for any taxable years beginning after December 31, 2017.

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

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

26 CFR 1.401(l)–1: Permitted disparity in employer-provided contributions or benefits

Rev. Rul. 2018–04

This revenue ruling provides tables of covered compensation under section 401(l)(5)(E) of the Internal Revenue Code and the Income Tax Regulations thereunder, for the 2018 plan year. These tables of covered compensation reflect a revision to the taxable wage base for 2018 that was announced by the Social Security Administration on November 27, 2017, and apply in lieu of the tables that were provided in Revenue Ruling 2017–22, 2017–48 I.R.B. 536, 2017.

Section 401(l)(5)(E)(i) defines covered compensation with respect to an employee as the average of the contribution and benefit bases in effect under section 230 of the Social Security Act (the "Act") for each year in the 35-year period ending with the year in which the employee attains social security retirement age.

Section 401(l)(5)(E)(ii) states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(l)–1(c)(34) of the Income Tax Regulations defines the taxable wage base as the contribution and benefit base under section 230 of the Act.

Section 1.401(l)–1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the employee's covered compensation for a plan year during which the 35-year period ends. An employee's covered compensation for a plan year beginning before the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(l)–1(c)(7)(ii) provides that, for purposes of determining the amount of an employee's covered compensation under § 1.401(l)–1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 2018 year, the taxable wage base is $128,400.

The following tables provide covered compensation for 2018.

ATTACHMENT I

2018 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2018 COVERED COMPENSATION TABLE II
1907	1972	$ 4,488
1908	1973	4,704
1909	1974	5,004
1910	1975	5,316
1911	1976	5,664
1912	1977	6,060
1913	1978	6,480
1914	1979	7,044
1915	1980	7,692
1916	1981	8,460
1917	1982	9,300
1918	1983	10,236
1919	1984	11,232
1920	1985	12,276
1921	1986	13,368

ATTACHMENT I

2018 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2018 COVERED COMPENSATION TABLE II
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	35,100
1936	2001	37,212
1937	2002	39,444
1938	2004	43,992
1939	2005	46,344
1940	2006	48,816
1941	2007	51,348
1942	2008	53,952
1943	2009	56,628
1944	2010	59,268
1945	2011	61,884
1946	2012	64,560
1947	2013	67,308
1948	2014	69,996
1949	2015	72,636
1950	2016	75,180
1951	2017	77,880
1952	2018	80,532
1953	2019	83,124
1954	2020	85,656
1955	2022	90,540
1956	2023	92,928
1957	2024	95,220
1958	2025	97,428
1959	2026	99,564
1960	2027	101,652
1961	2028	103,680
1962	2029	105,612
1963	2030	107,532

ATTACHMENT I

2018 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2018 COVERED COMPENSATION TABLE II
1964	2031	109,404
1965	2032	111,204
1966	2033	112,920
1967	2034	114,516
1968	2035	116,004
1969	2036	117,384
1970	2037	118,620
1971	2038	119,808
1972	2039	120,960
1973	2040	122,064
1974	2041	123,036
1975	2042	123,924
1976	2043	124,680
1977	2044	125,292
1978	2045	125,904
1979	2046	126,528
1980	2047	127,044
1981	2048	127,464
1982	2049	127,800
1983	2050	128,076
1984	2051	128,364
1985 and Later	2052 and Later	128,400

ATTACHMENT II

2018 ROUNDED COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	COVERED COMPENSATION ROUNDED
1937	$ 39,000
1938–1939	45,000
1940	48,000
1941	51,000
1942	54,000
1943	57,000
1944	60,000
1945	63,000
1946–1947	66,000
1948	69,000
1949	72,000
1950	75,000

ATTACHMENT II

2018 ROUNDED COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	COVERED COMPENSATION ROUNDED
1951	78,000
1952	81,000
1953	84,000
1954	87,000
1955	90,000
1956	93,000
1957–1958	96,000
1959	99,000
1960	102,000
1961–1962	105,000
1963–1964	108,000
1965	111,000
1966–1967	114,000
1968–1969	117,000
1970–1972	120,000
1973–1975	123,000
1976–1980	126,000
1981 and Later	128,400

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2017–22 is modified and superseded.

DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS participated in the development of this guidance. For further information regarding this notice, contact Mr. Morgan at 202-317-6700 or Michael Spaid at 206-946-3480 (not toll-free numbers).

Section 6221.—PROCEDURE AND ADMINISTRATION

26 CFR 301.6221(b)–1: Tax treatment determined at partnership level.

T.D. 9829

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Election Out of the Centralized Partnership Audit Regime

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations regarding the implementation of certain portions of section 1101 of the Bipartisan Budget Act of 2015 (BBA), which was enacted into law on November 2, 2015. Section 1101 of the BBA repeals the current rules governing partnership audits and replaces them with a new centralized partnership audit regime that, in general, assesses and collects tax at the partnership level. This document provides final regulations for electing out of the centralized partnership audit regime. The final regulations affect partnerships for taxable years beginning after December 31, 2017.

DATES: *Effective date*: These regulations are effective on January 2, 2018. *Applicability Date*: For dates of applicability, see § 301.6221(b)–1(f).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations under section 6221(b), Jennifer Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations to amend the Procedure and Administration Regulations (26 CFR Part 301) under Subpart – Tax Treatment of Partnership Items to implement the rules for electing out of the centralized partnership audit regime enacted by section 1101 of the BBA, Public Law 114–74.

Section 301.6221(b)–1 provides the rules regarding the ability of a partnership to elect out of the centralized partnership audit regime, including prescribing the time, form, and manner for making the election.

On June 14, 2017, the Treasury Department and the IRS published in the **Federal Register** (82 FR 27334) a notice of proposed rulemaking (REG–136118–15) proposing amendments to part 301 of title 26 of the Code of Federal Regulations (June 14 NPRM). The June 14 NPRM proposed rules under a number of provisions of the centralized partnership audit regime, including section 6221(b), regarding the election out of the regime. A public hearing regarding the proposed regulations was held on September 18, 2017. The IRS also received written public comments in response to the proposed regulations. After careful consideration of all written public comments and statements made during the public hearing, the portions of the proposed regulations relating to section 6221(b) are adopted as amended by this Treasury decision. The amendments to the proposed regulations are discussed in the next section.

Summary of Comments and Explanation of Revisions

In response to the June 14 NPRM, the IRS received 32 written comments, and five statements were provided at the public hearing. Of the 32 written comments, 16 addressed the proposed regulations under section 6221(b). All comments (both written and provided orally at the public hearing) were considered and written comments are available for public inspection at *www.regulations.gov* or upon request. This preamble addresses only the comments that addressed the proposed regulations under section 6221(b), which are the proposed regulations from the June 14 NPRM being finalized in this Treasury Decision. Comments, or any portion of a comment, which relate to other aspects of the proposed regulations in the June 14 NPRM will be addressed when final regulations regarding those provisions are published.

1. *Election Out of the Centralized Partnership Audit Regime*

The comments received with respect to proposed § 301.6221(b)–1 (regarding the election out of the centralized partnership audit regime) cover three general areas: (1) determining the number of partners of the partnership for purposes of determining whether the partnership has 100 or fewer partners under section 6221(b); (2) determining what partners constitute eligible partners for purposes of determining whether the partnership is an eligible partnership under section 6221(b); and (3) the mechanics of making the election under section 6221(b).

A. *Determining whether the partnership is eligible to elect out of the centralized partnership audit regime*

Proposed § 301.6221(b)–1(b)(1) provides that a partnership is eligible to elect out of the centralized partnership audit regime if the partnership has 100 or fewer partners for the taxable year, and all of the partners are eligible partners. Proposed § 301.6221(b)–1(b)(1)(i) provides that a partnership has 100 or fewer partners for the taxable year if it is required to furnish 100 or fewer statements under section 6031(b).

i. Determining the number of statements required to be furnished

Several comments suggested that statements furnished to certain types of partners should not be taken into account for purposes of determining whether the partnership is required to furnish 100 or fewer statements under section 6031(b) (the 100-or-fewer threshold). For example, one comment recommended that statements furnished to pass-through entities and disregarded entities should not count toward the 100-or-fewer threshold, and another comment recommended that spouses should count as a single partner for this purpose.

Section 6031(b) generally requires a partnership to furnish a statement to each person that is a partner in the partnership during the partnership taxable year regarding that partner's interest in the partnership for such year. If a pass-through entity or disregarded entity is a partner in the partnership, the partnership is required to furnish a statement under section 6031(b) to that pass-through entity or disregarded entity. *See* § 1.6031(b)–1T(a)(1) (statements required to be furnished to every person who was a partner (within the meaning of section 7701(a)(2)) at any time during the taxable year). Additionally, if two individuals are partners in a partnership, the partnership is required to furnish a statement under section 6031(b) to each of those individuals, regardless of whether they are married to one another. *Id.* Even though a pass-through entity or a disregarded entity is not an eligible partner (and a partnership with such partners would not be eligible to make an election under section 6221(b) regardless of the number of its partners), because the statute expressly provides that the 100-or-fewer threshold turns on the number of statements required to be furnished under section 6031(b), and section 6031(b) requires that the partnership furnish statements to all partners in the partnership during such taxable year regardless of whether the partner is a pass-through entity, a disregarded entity, or an individual who is married to another partner, these comments suggesting to the contrary were not adopted.

One comment suggested that the IRS should establish procedures to quickly address uncertainties regarding whether a statement was required to be issued under section 6031(b) for purposes of making an election under section 6221(b). The comment suggested that this could be accomplished through the private letter ruling process. Eligible partnerships can file an election out of the centralized partnership audit regime for taxable years beginning on or after January 1, 2018. Until the first partnership returns for taxable years subject to the new regime are filed and any elections out of the new regime are reviewed, it is difficult to determine whether a pre-filing procedure for providing legal determinations regarding section 6031(b) for purposes of making the election under section 6221(b) would be helpful or appropriate. Additionally, there is longstanding guidance regarding whether a partnership is required to furnish a statement under section 6031(b) to a particular person. *Id.* Therefore, because there is sufficient existing guidance regarding whether statements are required to be furnished under section 6031(b) and because the centralized partnership audit regime does not alter that existing guidance, the Treasury Department and the IRS have chosen not to adopt the suggestion to establish a pre-filing procedure specific to section 6221(b) in the final regulations. The IRS may reconsider whether a pre-filing procedure would be helpful after gaining experience with the election out procedures under section 6221(b). If it becomes apparent that a pre-filing procedure might prove useful in the context of section 6221(b), the Treasury Department and the IRS will consider at that time whether to establish such a procedure in other guidance, forms, or instructions. Additionally, nothing in these regulations prohibits a partnership from utilizing existing procedures for requesting private letter rulings or other guidance from the IRS concerning section 6031(b).

Two comments were received with respect to Example 2 under proposed § 301.6221(b)–1(b)(2)(iii). One comment suggested removing certain assumptions set forth in the example because those assumptions were not relevant to the conclusion reached in the example. Specifically, the comment suggested removing the following assumed facts – 1) that Spouse 1 and Spouse 2 have lived in a community property state at all times since they were married; and 2) that Spouse 1 acquired the partnership interest while married to Spouse 2. The comment suggested replacing those assumed facts with a statement that Spouse 2 only has a community property interest in the partnership. A second comment recommended that the regulations expressly state that one spouse's community property interest is not taken into account for purposes of determining the number of statements the partnership is required to furnish under section 6031(b).

The intent of Example 2 under proposed § 301.6221(b)–1(b)(2)(iii) was to illustrate that whether a partnership is required to furnish a statement for purposes of section 6221(b) is determined by looking only to section 6031(b). The example was not intended to illustrate any principles of the various states' community property laws. For these reasons, the two facts identified by the first comment were removed and replaced with a statement that, as a matter of state law, Spouse 2 has a community property interest in Spouse 1's partnership interest.

The second comment suggested that the regulations under section 6221(b) specifically address community property interests. The determination of whether a partnership is required to furnish a statement is governed by section 6031(b) and the regulations thereunder. Creating a specific rule potentially at odds with the existing rules under section 6031(b) in these regulations could result in confusion regarding the proper operation of existing section 6031(b) rules and is not necessary for implementation of section 6221(b). Accordingly, the second comment suggesting the regulations expressly state that one spouse's community property interest is not taken into account for purposes of determining the number of statements the partnership is required to furnish under section 6031(b) was not adopted.

ii. Constructive or de facto partnerships

Several comments were received regarding the statement in the preamble of the June 14 NPRM that noted the IRS' intention to carefully scrutinize whether two or more partnerships that have elected out under section 6221(b) should be recast under existing judicial doctrines and general federal tax principles as having formed one or more constructive or de facto partnerships for federal income tax purposes. The preamble also listed several factors the IRS would consider when examining such arrangements and noted that, if two or more partnerships were recast under those doctrines and principles, the constructive or de facto partnership would be subject to the centralized partnership audit regime because it would not have made a timely election under section 6221(b). Several comments suggested rules to address those statements in the preamble, including suggesting that the final regulations should provide: 1) clear standards and safe harbors for when the IRS will determine if a constructive or de facto partnership exists and the effects of determining that two or more partnerships are constructively a single partnership; 2) a rule that any constructive or de facto partnership should be able to appeal that determination, including to the United States Tax Court; and 3) a reasonable amount of time for a constructive or de facto partnership to make an election under section 6221(b).

The statements in the preamble of the June 14 NPRM referencing the IRS's intention to carefully examine whether two or more partnerships should be recast or be treated as having formed one or more constructive or de facto partnerships for federal income tax purposes reference existing judicial doctrines and general federal tax principles existing outside the centralized partnership audit regime. These existing judicial doctrines and bodies of law under the Internal Revenue Code (Code) govern whether a partnership is in existence, which is not an issue specific to (or altered by) the centralized partnership audit regime. However, if the IRS were to invoke these existing judicial doctrines and bodies of law and recast two partnerships as one or determine a partnership existed where no return was filed, there would likely be consequences under the centralized partnership audit regime as outlined in the preamble to the June 14 NPRM. For that reason, the statements in the preamble to the June 14 NPRM were meant to alert taxpayers to these existing judicial doctrines and bodies of law and to the fact that they might be applicable. Nothing in the June 14 NPRM or in this Treasury Decision alters these existing judicial doctrines and bodies of law governing whether a partnership is in existence. Accordingly, the final regulations do not adopt the comments requesting rules under the existing judicial doctrines and bodies of law governing whether a partnership is in existence.

Any application by the IRS of those existing judicial doctrines and bodies of law to two or more partnerships would require the IRS to follow all applicable due process requirements, including those under the centralized partnership audit regime. A taxpayer would have any applicable administrative review in accordance with IRS procedures and judicial review as provided by existing provisions of law.

With regard to the comment requesting a reasonable amount of time for a constructive or de facto partnership to make an election under section 6221(b), the time to make an election under section 6221(b) is specifically prescribed by statute. Section 6221(b)(1)(D)(i) expressly provides that an election under section 6221(b) is made on a timely filed return for the taxable year.

Finally, the United States Tax Court is a court of limited jurisdiction. *See* section 7442. The Treasury Department and the IRS do not have authority to confer jurisdiction on the United States Tax Court. As the IRS gains experience with the centralized partnership audit regime, the IRS may consider issuing sub-regulatory guidance covering elections under section 6221(b) in the context of constructive and de facto partnerships. The comments regarding constructive and de facto partnerships, however, were not adopted in these final regulations.

B. *Eligible partners*

Under section 6221(b)(1)(C), one of the criteria for a partnership to make an election under section 6221(b) is that each of the partners of the partnership is an individual, C corporation, foreign entity that would be treated as a C corporation if it were a domestic entity, S corporation, or estate of a deceased partner. Proposed § 301.6221(b)–1(b)(3) describes these partners as "eligible partners". Proposed § 301.6221(b)–1(b)(3)(ii) provides that some partners are not eligible partners, such as partnerships, trusts, disregarded entities, nominees or other similar persons that hold an interest on behalf of another person, and estates other than the estate of a deceased partner. In the case of an eligible partner that is an S corporation (S corporation partner), the statements required to be furnished by the S corporation partner under section 6037(b) for its taxable year ending with or within the partnership's taxable year are treated as statements furnished by the partnership for purposes of determining whether the partnership is required to furnish 100 or fewer statements. Section 6221(b)(2)(A)(ii). The statement furnished to the S corporation partner by the partnership also counts towards the 100-or-fewer threshold. In addition, the partnership must disclose the names and taxpayer identification numbers (TIN) for each person with respect to whom the S corporation partner was required to furnish a statement under section 6037(b). Under section 6221(b)(2)(C), the Secretary is authorized by regulation or other guidance to prescribe rules similar to the rules for S corporation partners with respect to other types of persons not specifically described as eligible partners under section 6221(b)(1)(C).

The preamble to the June 14 NPRM explains that the Treasury Department and the IRS considered but did not adopt comments in response to Notice 2016–23, 2016–13 I.R.B. 490 (March 28, 2016) that suggested that the Treasury Department and the IRS exercise authority under section 6221(b)(2)(C) to expand the types of persons that are eligible partners for purposes of the election out rules under section 6221(b). The June 14 NPRM explains that broadening the scope of the election out provisions to include additional types of partners or partnership structures would increase the administrative burden on the IRS because those structures and partners would need to be audited under the deficiency procedures. The preamble to the June 14 NPRM requested comments on any potential expansion of the election out rules, noting that comments are particularly helpful if they address the additional burdens that expansion of the rules would impose on the IRS, in addition to the decreased burden on taxpayers resulting from such an expansion.

In response to the June 14 NPRM, the Treasury Department and the IRS received many comments similar to the comments received in response to Notice 2016–23 requesting that the Treasury Department and the IRS exercise the discretionary authority provided in section 6221(b)(2)(C) to expand the definition of eligible partner. Comments suggested that partnerships, disregarded entities, trusts (including tax-exempt trusts, revocable trusts, charitable remainder trusts, grantor trusts, and nongrantor trusts), individual retirement accounts, nominees, qualified pension plans, profit-sharing plans, and stock bonus plans should be considered eligible partners for purposes of making an election under section 6221(b). Comments specifically suggested that because certain types of entities, such as trusts, are similarly situated to certain eligible partners, such as S corporations because those entities are audited and report items to their owners similarly, they should be included within the definition of eligible partner, and that excluding them could lead to treating similarly situated taxpayers differently. For example, one comment noted that a tax-exempt organization organized as a C corporation is an eligible partner while a tax-exempt organization organized as a trust is not an eligible partner, even though both organizations are taxed the same way.

One comment suggested that all tiered partnerships should be eligible to make an election under section 6221(b) under rules similar to the rules that apply to S corporation partners, which would require counting the number of statements required to be furnished by each pass-through partner toward the 100-or-fewer threshold under proposed § 301.6221(b)–1(b)(2). Another comment recommended that the IRS develop an administrable election out for tiered partnerships. The comments suggested that such rules could allow for tiered partnerships to be collapsed down to their ultimate beneficial owners and permit that collapsed structure to make an election out, provided there was a "manageable" number of ultimate beneficial owners and the beneficial owners were all eligible partners.

In addition, multiple comments suggested that the authority granted in section 6221(b)(2)(C) signified a congressional expectation that the Treasury Department and the IRS would expand the list of eligible partners under section 6221(b)(1)(C). Multiple comments also suggested that the General Explanations of Tax Legislation Enacted in 2015 prepared by the Joint Committee on Taxation supported an expansion of the section 6221(b)(1)(C) list. *See* Joint Comm. on Taxation, JCS-1–16, *General Explanation of Tax Legislation Enacted in 2015*, 59–60 (2016). Other comments observed that the differences between the election out rules under section 6221(b) and the small partnership exception under the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248 (TEFRA) – the increase from 10 to 100 partners and the inclusion of S corporation partners – reflected an awareness that the IRS would face additional administrative burdens as a result of the election out rules.

Comments suggested that in some situations there would be minimal or no additional burdens imposed on the IRS resulting from an expansion of the definition of eligible partner. For example, comments suggested that, because there is only one additional layer of ownership beyond an entity that is disregarded as an entity separate from its owner for Federal tax purposes, adding those types of entities to the definition of eligible partner would not increase audit complexity or administrative burden for the IRS.

Some comments suggested that maintaining the current definition of eligible partner in proposed § 301.6221(b)–1(b)(3) would actually lead to more administrative burden for the IRS. For example, one comment suggested that because some tiered partnerships are ultimately owned by members of the same affiliated group, it would be more burdensome to conduct separate examinations (one for the partnership under the centralized partnership audit regime and one for the consolidated group under the deficiency procedures), rather than examining all entities as part of the same proceeding. Another comment observed that in some cases, certain partnership structures that are relatively complex and therefore difficult to audit would be able to elect out, while other more simple structures, which are potentially less burdensome to audit, could not elect out. One comment suggested that by not expanding the types of entities that are eligible partners more partnerships will be subject to the centralized partnership audit regime, and the IRS and taxpayers will face additional burdens because they have to apply the new audit rules, rather than applying longstanding rules familiar to both the IRS and to taxpayers.

Other comments noted the consequences to partnerships and partnership interests of not expanding the definition of eligible partner to include disregarded entities or trusts. For example, one comment suggested that not expanding the types of entities that are eligible partners would result in taxpayers transferring partnership interests from disregarded entities to eligible partners, leading to unnecessary filings and paperwork with limited effect on the ultimate taxpayers' liabilities. Another comment suggested that not expanding the types of entities that are eligible partners would cause a reduction in value of limited partnership interests because of the increased risks and burdens associated with an audit under the centralized partnership audit regime. Another comment noted that the centralized partnership audit regime shifts certain administrative functions from the IRS to taxpayers, functions that were typically performed by the IRS under TEFRA.

The Treasury Department and the IRS have carefully considered all of the comments suggesting an expansion of the definition of eligible partner, but have decided not to adopt these comments at this time. In making this determination, the Treasury Department and the IRS considered the burdens of the centralized partnership audit regime on taxpayers and have concluded that the interests of efficient tax administration outweigh those potential burdens. Accordingly, the final regulations do not expand the definition of eligible partner to include entities other than those entities expressly provided in section 6221(b)(1)(C). After gaining experience with the centralized partnership audit regime, the Treasury Department and the IRS will be in a better position to reconsider any expansion of partnerships eligible to elect out of the regime.

Expanding the current definition of eligible partner would result in more partnerships electing out of the centralized partnership audit regime. In turn, this would result in more audits under the deficiency procedures for taxpayers owning interests in partnerships. When a partnership makes a valid election out of the centralized partnership audit regime under section 6221(b), the IRS must follow the deficiency procedures to audit, assess, and collect tax from the ultimate owners of that partnership. Under the partnership audit procedures enacted as part of TEFRA, the IRS conducted a unified examination of the partnership's items at the partnership level, but was still required to separately assess and collect tax from the ultimate owners of the partnership (sometimes through deficiency procedures).

The centralized partnership audit regime is designed to improve upon both the TEFRA rules and the deficiency procedures by providing for a centralized audit proceeding with respect to the partnership and mandating centralized assessment and collection of tax, penalties, and interest from the partnership. It follows then that rules designed to limit the number of partnerships that can elect out of the new regime is consistent with this objective.

Further, for each additional type of partner that is added to the list of eligible partners, the IRS will be required to follow deficiency procedures with respect to the indirect partners of that partner to assess and collect tax resulting from a partnership audit that could otherwise be assessed and collected against a single partnership under the centralized partnership audit regime. As noted in the preamble to the June 14 NPRM, the number of partnerships has grown substantially in recent years and is likely to continue to grow, compounding the audit and collection inefficiencies extant outside of the new regime for the IRS with each expansion of the eligible partner list. It would undermine the benefits of the new regime to expand the group of partnerships that are eligible to elect out of the new regime. Moreover, it would be unwise to do so at a time before the first returns for taxable years subject to the new regime have been filed.

There may be some situations where expanding eligible partners would not add significantly more complexity to an examination, even under the deficiency procedures. However, while this may occur in some instances, the rules under section 6221(b) are designed to be of general applicability to all partnerships, regardless of size and composition of partners. Section 6221(b)(1) sets the parameters for making an election out of the centralized partnership audit regime, and partnerships that meet these requirements are eligible to make an election under section 6221(b) regardless of how complex or simple their partnership structure is. While certain types of partnerships that elect out may present less audit burden than others, as the total number of partners increases, so too does the number and the complexity of deficiency proceedings. Therefore, any potential simplification of an audit for one particular partnership that might result from the expansion of the election out rules must be appropriately balanced against the increasing audit burden on the IRS if the total number of partnerships that can elect out is increased.

The Treasury Department and the IRS acknowledge that the new rules are a significant change in the way partnerships have been traditionally audited, particularly in the imposition of an imputed underpayment at the partnership level. Comments have raised concerns that the imputed underpayment may not accurately reflect the tax liability that would have been owed had the partnership and the partners reported correctly in the reviewed year taking the partners' specific facts and circumstances into account. However, partnerships and partners have the means to mitigate those concerns by utilizing the modification procedures under section 6225 or making the election under section 6226 (the alternative to payment of the imputed underpayment).

As the Treasury Department and the IRS gain experience with the centralized partnership audit regime, the definition of eligible partner may be revisited. Section 6221(b)(2)(C) allows the Treasury Department and the IRS to expand the types of eligible partners through "other guidance," which includes sub-regulatory guidance that can be more easily tailored and adapted as the Treasury Department and the IRS gain experience with the new regime. Until that time, however, the list of eligible partners will remain the list specifically set forth by Congress in section 6221(b)(1)(C).

In addition to the comments about expanding the definition of eligible partner, one comment recommended clarifying the meaning and application of the phrase "a nominee or other similar person that holds an interest on behalf of another person" under proposed § 301.6221(b)–1(b)(3)(ii)(E). The comment stated that the meaning of the quoted language was unclear. The intent of this provision was not to create a new concept that does not currently exist in the Code and regulations. Instead, the intent of the provision was to include in the list of ineligible partners situations where the partner holds an interest on behalf of another person. To remove the ambiguity, the quoted language was clarified to remove the word "nominee" as a separate clause and provides instead that a partner is not an eligible partner if that partner holds an interest in the partnership on behalf of another person.

C. Making the election under section 6221(b)

Proposed § 301.6221(b)–1(c) provides that an election out of the centralized partnership audit regime must be made on an eligible partnership's timely filed return, including extensions, for the taxable year to which the election applies, and, once made cannot be revoked without the consent of the IRS. Additionally, under proposed § 301.6221(b)–1(c)(2), the election must include each partner's name, correct U.S. TIN, and Federal tax classification. If the election is being made by a partnership that has an S corporation as a partner, proposed § 301.6221(b)–1(c)(2) provides that the election must also include each S corporation shareholder's name, correct U.S. TIN, and Federal tax classification. Proposed § 301.6221(b)–1(c)(2) also provides that the election must include an affirmative statement that the partner is an eligible partner and any other information required by the IRS in forms, instructions, or other guidance. Under proposed § 301.6221(b)–1(c)(3), if a partnership makes an election under section 6221(b), the partnership must notify its partners of the election within 30 days of making the election. Under proposed § 301.6221(b)–1(e)(2), if the IRS determines that a purported election by a partnership is invalid, the IRS will notify the partnership in writing, and the provisions of the centralized partnership audit regime will apply to the partnership.

One comment suggested that the regulations clarify whether a "timely filed return" under proposed § 301.6221(b)–1(c)(1) is limited to the partnership's original return or whether it also includes any amended returns filed before the due date of the original return. The definition of whether a return is a timely filed return is covered by other provisions of the Code, and the proposed regulations do not modify the longstanding interpretation of those provisions. Under that longstanding interpretation, a return is timely filed if it is filed prior to the due date of the return (taking into account any applicable extensions), regardless of whether it is the original return filed by the partnership or a return filed subsequent to the original return but before the extended due date of the return. *See Haggar Co. v. Helvering*, 308 U.S. 389 (1940). Therefore, the comment requesting that the regulations clarify the phrase "timely filed return" in proposed § 301.6221(b)–1(c)(1) was not adopted.

Two comments were received regarding the rule under proposed § 301.6221(b)–1(c)(1) that requires consent of the IRS to revoke an election previously made by the partnership. One comment suggested that partnerships should have the ability to revoke the election under section 6221(b) without the consent of the IRS and suggested that such a rule could result in more partnerships revoking elections and therefore becoming subject to the centralized partnership audit regime. Section 6221(b) is silent as to whether a partnership may revoke its election.

The June 14 NPRM allows a partnership to request revocation of its election under section 6221(b) with consent of the IRS. IRS consent is necessary for this type of election revocation because of the potential for detrimental effects on tax administration. By making an election under section 6221(b), the partnership is representing to the IRS that the partnership seeks to elect out of the centralized partnership audit regime. If a partnership is able to unilaterally revoke the election, the partnership is changing that representation without the IRS's knowledge which, under certain circumstances, could be detrimental to tax administration. For example, a partnership could make an election under section 6221(b) and subsequently revoke the election at a time when the period of limitations on making partnership adjustments under section 6235 is close to expiring, or would have already expired, even though the individual partners' periods of limitations on assessment might still be open. If unilateral revocations were permissible, the IRS would have to obtain protective statute extensions creating unnecessary burden on both partners and the IRS. Because the partnership's unilateral revocation of an election under section 6221(b) could be detrimental to tax administration, it is necessary to require IRS consent prior to any revocation. While allowing revocation without consent could potentially result in more partnerships subject to the centralized partnership audit regime, there is no reason to believe that requiring consent significantly alters the number of potential revocations, except in situations where the revocation was clearly detrimental to tax administration. Accordingly, the comment suggesting that the partnership can revoke the election without the consent of the IRS was not adopted.

Another comment recommended that the IRS provide rules on how a partnership requests the consent of the IRS to revoke an election and the standards the IRS will use to grant or deny such requests. The Treasury Department and the IRS have determined that these procedures are more appropriately addressed in non-regulatory guidance. This will enable the IRS to more quickly adjust the process, respond to feedback, and fix any potential problems as it gains more experience with elections under section 6221(b). Accordingly, these final regulations do not adopt this comment.

Section 6221(b)(2)(B) provides that the IRS may provide an alternative form of identification for foreign partners. The June 14 NPRM does not provide for a form of alternative identification for foreign partners, but instead requires that all partners of an eligible partnership have a U.S. TIN. The preamble to the June 14 NPRM explains that partners in a U.S partnership, including foreign partners, are required to have a U.S TIN, so an alternative form of identification may be unnecessary. However, the June 14 NPRM requested comments regarding situations in which a foreign partner subject to the centralized partnership audit regime may not otherwise be required to have a U.S. TIN, other than for the election under section 6221(b), and requested recommendations for alternative identification procedures that could be used in such cases.

Two comments made suggestions regarding a possible alternative method for identifying foreign partners when the partnership discloses partner information to the IRS as part of an election under section 6221(b). One comment recommended that "in the case of foreign partners who are individuals, the final Regulations provide that the partnership can submit a completed Form W-8 in lieu of the foreign partner's TIN." Another comment suggested that all foreign partners should be required to have TINs for a partnership to be eligible to make an election under section 6221(b).

Consistent with the second comment, the final regulations retain the approach of the proposed regulations and require a partnership to provide a correct U.S. TIN for all partners (foreign and domestic) as part of a valid election under section 6221(b). Requiring a U.S. TIN for all partners of a partnership treats all partners the same, regardless of whether they are foreign or domestic, and ensures that the partners of the partnership can be easily identified. However, the Treasury Department and the IRS intend to continue to study this issue and may, in the future, provide for alternative identification for foreign partners in forms, instructions, and other guidance. To account for any future forms of alternative identification for foreign partners, § 301.6221(b)–1(c)(2) provides that a partnership must disclose the name and U.S. TIN, or alternative form of identification required by forms, instructions, or other guidance, for each partner of the partnership or each shareholder of an S corporation partner.

Another comment stated that the language in proposed § 301.6221(b)–1(c)(2), which requires a partnership to provide information regarding "each shareholder of the S corporation", was not clear because it did not specify whether the partnership was required to provide information regarding S corporation shareholders as of a specific date or whether information was required of any person who was a shareholder at any point during the S corporation's taxable year. The IRS and Treasury Department agree that the language in proposed § 301.6221(b)–1(c)(2) should be clarified. Section 6221(b)(2)(A)(i) provides that the S corporation shareholders the partnership must identify are those shareholders with respect to whom the S corporation partner is required to furnish statements under section 6037(b) for the taxable year of the S corporation ending with or within the partnership taxable year for which the election is being made. Accordingly, the final regulations in § 301.6221(b)–1(c)(2) provide that, as part of a valid election, a partnership must disclose the required information about each person who was a shareholder in the S corporation partner at any time during the taxable year of the S corporation ending with or within the partnership's taxable year.

Regarding the requirement that a partnership making an election under section 6221(b) include an affirmative statement that each partner is an eligible partner, a comment was received recommending that the affirmative statement should appear on the bottom of the form for making the election or be a return attachment that could be signed by anyone eligible to sign the partnership return. This comment and recommendation concerns forms and instructions that will be prescribed by the IRS, and therefore the comment is outside the scope of these regulations. However, the IRS will consider this comment when creating the forms and instructions necessary to implement the election out of the centralized partnership audit regime.

Two comments addressed the requirement that the partnership notify its partners of any election made under section 6221(b) within 30 days of making the election. Proposed § 301.6221(b)–1(c)(3) requires a partnership that makes an election under section 6221(b) to notify its partners within 30 days of making the election. One comment requested that the final regulations clarify whether the partnership has to notify shareholders of an S corporation partner that the partnership has made the election. Under TEFRA, the term "partner" was defined to include both direct and indirect partners. *See* section 6231(a)(2) (prior to amendment by the BBA). Section 1101(a) of the BBA repealed the partnership audit procedures under TEFRA, including the definition of partner. As a result, the only operative definition of the term "partner" in the Code is located in section 7701(a)(2). Under that definition, shareholders of an S corporation partner are not partners in the partnership making the election under section 6221(b) because they are not members of the partnership. Therefore, the partnership does not have to provide notice to the shareholders of an S corporation partner because those shareholders are not "its partners" within the meaning of § 301.6221(b)–1(c)(3). Accordingly, because the regulation is clear that the partnership only has to provide notice to its partners, this comment recommending that the regulation be clarified on this point was not adopted. Further, it would be burdensome for the partnership making the election to have to notify both the S corporation and the S corporation shareholders. It should be sufficient that the partnership notify its partner, the S corporation. Whether and how the S corporation wishes to notify its shareholders is something that is left to the S corporation and its shareholders to determine.

Two comments suggested that the IRS should add a checkbox to the statements required to be furnished by the partnership under section 6031(b) indicating that the partnership has made an election under section 6221(b). The checkbox would serve as the notification of the election as required by § 301.6221(b)–1(c)(3). This comment was not adopted because the regulations intentionally do not prescribe the method a partnership must use to notify its partners of the election. Under the regulations, the partnership has the flexibility to notify its partners in the manner that is in the best interests of the partnership and its partners. At this point, the Treasury Department and the IRS have considered the method the partnership notifies its partners to be a business decision of the partnership. Section 6221(b) requires only that the partnership notify its partners in the manner prescribed by the Treasury Department and the IRS. Accordingly, the Treasury Department and the IRS have refrained from regulating more specifically on this issue, and therefore this comment was not adopted. However, the proposed regulations are amended in the final regulations to make clear that the manner of notification is left to the partnership to determine.

One comment recommended that the final regulations include a mechanism for allowing the partnership to make corrections to the election to cure any compliance errors. The Treasury Department and the IRS determined that these procedures, if needed, are more appropriately addressed in sub-regulatory guidance, which is more routinely updated and can be improved based upon experience. Under § 301.6221(b)–1(e) and as explained more fully in the preamble to the June 14 NPRM, an election under section 6221(b) may be relied upon unless challenged by the IRS. That includes situations where the election is not fully compliant with all applicable rules. As provided under § 301.6221(b)–1(e)(2), the IRS will notify the partnership if the IRS determines the partnership's election is invalid. Nothing in these regulations prohibits the partnership from working with the IRS if an election is deficient to correct any minor errors. By not providing a correction procedure in the regulations, the IRS and the partnership have more flexibility to address any errors in an election that may not be afforded if the regulations provided for rules for some situations but not others. Accordingly, the comment to include a correction procedure in the regulations was not adopted.

Finally, one comment recommended that the final regulations place a reasonable restriction on the time the IRS has to determine whether an election under section 6221(b) is invalid. The comment suggested that a period of 180 days from the filing of the return would be a reasonable time. This comment was not adopted because this would effectively impose a significant shortening of the period of limitations on when the IRS would be able to examine a partnership's return and make adjustments. Limiting the time within which the IRS may review the validity of an election would effectively force the IRS to decide within that specified time period whether it intended to review the election, even if the IRS had no intention at that time of ultimately examining the partnership's return.

Section 6221(b) did not provide a specific period of limitations for a determination that an election under section 6221(b) is invalid. Nevertheless, the period for determining an election purportedly made under section 6221(b) is invalid is not unlimited. The period of limitations on making adjustments under section 6235 limits the time within which the IRS may make a partnership adjustment, which will also serve as a practical limitation on when the IRS must decide whether to determine an election under section 6221(b) is invalid. If a purported election is determined to be invalid by the IRS, the partnership would be subject to the centralized partnership audit regime, and no partnership adjustment could be made by the IRS after the period prescribed in section 6235. For the reasons state above, the comment to establish a separate period for evaluating elections was not adopted.

In addition to addressing the comments received in response to the June 14 NPRM, this Treasury Decision also makes editorial, non-substantive changes to the proposed regulations under section 6221(b).

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory impact assessment is not required.

It is hereby certified that these rules will not have a significant economic impact on a substantial number of small entities. Although these rules may affect a substantial number of small entities, the economic impact is not substantial because these rules merely provide guidance on the statutory requirements for making an election out of the centralized partnership audit regime. These rules reduce the existing burden on partnerships to comply with the statutory requirements by providing clear rules and guidance regarding the statutory requirements for partnerships desiring to make an election out of the centralized partnership audit regime under section 6221(b). For the reasons stated, the final rules will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

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

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *www.irs.gov*.

Drafting Information

The principal author of these final regulations is Jennifer M. Black of the Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in their development.

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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 301.6221(b)–1 is added to read as follows:

§ 301.6221(b)–1 Election out for certain partnerships with 100 or fewer partners.

(a) *In general*. The provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C of chapter 63) do not apply for any partnership taxable year for which an eligible partnership under paragraph (b) of this section makes a valid election in accordance with paragraph (c) of this section. For rules regarding deficiency procedures, see subchapter B of chapter 63 of the Internal Revenue Code and §§ 301.6211–1 through 301.6215–1.

(b) *Eligible partnership*—(1) *In general*. Only an eligible partnership may make an election under this section. A partnership is an eligible partnership for purposes of this section if—

(i) The partnership has 100 or fewer partners as determined in accordance with paragraph (b)(2) of this section, and

(ii) Each statement the partnership is required to furnish under section 6031(b) for the partnership taxable year is furnished to a partner that was an eligible partner (as defined in paragraph (b)(3) of this section) for the partnership's entire taxable year.

(2) *100 or fewer partners*—(i) *In general*. Except as provided in paragraph (b)(2)(ii) of this section, a partnership has 100 or fewer partners if the partnership is required to furnish 100 or fewer statements under section 6031(b) for the taxable year.

(ii) *Special rule for S corporations*. For purposes of this paragraph (b)(2), a partnership with a partner that is an S corporation (as defined in section 1361(a)(1)) must take into account each statement required to be furnished by the S corporation to its shareholders under section 6037(b) for the taxable year of the S corporation ending with or within the partnership's taxable year.

(iii) *Examples*. The following examples illustrate the provisions of this paragraph (b)(2). For purposes of these examples, each partnership is required to file a return under section 6031(a):

Example 1. During its 2020 partnership taxable year, Partnership has four partners each owning an interest in Partnership. Two of the partners are Spouse 1 and Spouse 2 who are married to each other during all of 2020. Spouse 1 and Spouse 2 each own a separate interest in Partnership. The two other partners are unmarried individuals. Under section 6031(b), Partnership is required to furnish a separate statement (that is, Schedule K–1 (Form 1065), *Partner's Share of Income, Deductions, Credits, etc*.) to each individual partner, including separate statements to Spouse 1 and Spouse 2. Therefore, for purposes of this paragraph (b)(2), Partnership has four partners during its 2020 taxable year.

Example 2. The facts are the same as in *Example 1* of this paragraph (b)(2)(iii), except Spouse 2 does not separately own an interest in Partnership during 2020 and Spouse 1 and Spouse 2 live in a community property state, State A. Spouse 1 acquired the partnership interest in such a manner that by operation of State A law, Spouse 2 has a community property interest in Spouse 1's partnership interest. Because Spouse 2's community property interest in Spouse 1's partnership interest is not taken into account for purposes of determining the number of statements Partnership is required to furnish under section 6031(b), Partnership is required to furnish a statement to Spouse 1, but not to Spouse 2. Therefore, for purposes of this paragraph (b)(2), Partnership has three partners during its 2020 taxable year.

Example 3. At the beginning of 2020, Partnership, which has a taxable year ending December 31, 2020, has three partners - individuals A, B, and C. Each individual owns an interest in Partnership. On June 30, 2020, Individual A dies, and A's interest in Partnership becomes an asset of A's estate. A's estate owns the interest for the remainder of 2020. On September 1, 2020, B sells his interest in Partnership to Individual D, who holds the interest for the remainder of the year. Under section 6031(b), Partnership is required to furnish five statements for its 2020 taxable year – one each to Individual A, the estate of Individual A, Individual B, Individual C, and Individual D. Therefore, for purposes of this paragraph (b)(2), Partnership has five partners during its 2020 taxable year.

Example 4. During its 2020 taxable year, Partnership has 51 partners - 50 partners who are individuals and S, an S corporation. S and Partnership are both calendar year taxpayers. S has 50 shareholders during the 2020 taxable year. Under section 6031(b), Partnership is required to furnish 51 statements for the 2020 taxable year – one to S and one to each of Partnership's 50 partners who are individuals. Under section 6037(b), S is required to furnish a statement (that is, Schedule K–1 (Form 1120–S), *Shareholder's Share of Income, Deductions, Credits, etc*.) to each of its 50 shareholders. Under paragraph (b)(2)(ii) of this section, the number of statements required to be furnished by S under section 6037(b), which is 50, is taken into account to determine whether partnership has 100 or fewer partners. Accordingly, for purposes of this paragraph (b)(2), Partnership has a total of 101 partners (51 statements furnished by Partnership to its partners plus 50 statements furnished by S to its shareholders) and is therefore not an eligible partnership under paragraph (b)(1) of this section. Because Partnership is not an eligible partnership, it cannot make the election under paragraph (a) of this section.

Example 5. During its 2020 taxable year, Partnership has two partners, A, an individual, and E, an estate of a deceased partner. E has 10 beneficiaries. Under section 6031(b), Partnership is required to furnish two statements, one to A and one to E. Any statements that E may be required to furnish to its beneficiaries are not taken into account for purposes of this paragraph (b)(2). Therefore, for purposes of this paragraph (b)(2), Partnership has two partners.

(3) *Eligible Partners*—(i) *In general*. For purposes of paragraph (b)(1)(ii) of this section, the term *eligible partner* means a partner that is an individual, a C corporation (as defined by section 1361(a)(2)), an eligible foreign entity described in paragraph (b)(3)(iii) of this section, an S corporation, or an estate of a deceased partner. An S corporation is an eligible partner regardless of whether one or more shareholders of the S corporation are not an eligible partner.

(ii) *Partners that are not eligible partners*. A partner is not an eligible partner under paragraph (b)(3)(i) of this section if the partner is —

(A) A partnership,

(B) A trust,

(C) A foreign entity that is not an eligible foreign entity described in paragraph (b)(3)(iii) of this section,

(D) A disregarded entity described in § 301.7701–2(c)(2)(i),

(E) An estate of an individual other than a deceased partner, or

(F) Any person that holds an interest in the partnership on behalf of another person.

(iii) *Eligible foreign entity*. For purposes of this paragraph (b)(3), a foreign entity is an eligible partner if the foreign entity would be treated as a C corporation if it were a domestic entity. For purposes of the preceding sentence, a foreign entity would be treated as a C corporation if it were a domestic entity if the entity is classified as a per se corporation under § 301.7701–2(b)(1), (3), (4), (5), (6), (7), or (8), is classified by default as an association taxable as a corporation under § 301.7701–3(b)(2)(i)(B), or is classified as an association taxable as a corporation in accordance with an election under § 301.7701–3(c).

(iv) *Examples*. The following examples illustrate the rules of this paragraph (b)(3). For purposes of these examples, each partnership is required to file a return under section 6031(a):

Example 1. During the 2020 taxable year, Partnership has four equal partners. Two partners are individuals. One partner is a C corporation. The fourth partner, D, is a partnership. Because D is a partnership, D is not an eligible partner under paragraph (b)(3)(i) of this section. Accordingly, Partnership is not an eligible partnership under paragraph (b)(1) of this section and, therefore, cannot make the election under paragraph (a) of this section for its 2020 taxable year.

Example 2. During its 2020 taxable year, Partnership has four equal partners. Two partners are individuals. One partner is a C corporation. The fourth partner, S, is an S corporation. S has ten shareholders. One of S's shareholders is a disregarded entity, and one is a qualified small business trust. S is an eligible partner under paragraph (b)(3)(i) of this section even though S's shareholders would not be considered eligible partners if those shareholders held direct interests in Partnership. See paragraph (b)(3)(i) of this section. Accordingly, Partnership meets the requirements under this paragraph (b)(3) for its 2020 taxable year.

Example 3. During its 2020 taxable year, Partnership has two equal partners, A, an individual, and C, a disregarded entity, wholly owned by B, an individual. C is not an eligible partner under paragraph (b)(3)(i) of this section. Accordingly, Partnership is not an eligible partnership under paragraph (b)(1) of this section and, therefore, is ineligible to make the election under paragraph (a) of this section for its 2020 taxable year.

(c) *Election*—(1) *In general*. An election under this section must be made on the eligible partnership's timely filed return, including extensions, for the taxable year to which the election applies and include all information required by the Internal Revenue Service (IRS) in forms, instructions, or other guidance. An election is not valid unless the partnership discloses to the IRS all of the information required under paragraph (c)(2) of this section and, in the case of a partner that is an S corporation, the shareholders of such S corporation. An election once made may not be revoked without the consent of the IRS.

(2) *Disclosure of partner information to the IRS*. A partnership making an election under this section must disclose to the IRS information about each person that was a partner at any time during the taxable year of the partnership to which the election applies, including each partner's name and correct U.S. taxpayer identification number (TIN) (or alternative form of identification required by forms, instructions, or other guidance), each partner's Federal tax classification, an affirmative statement that the partner is an eligible partner under paragraph (b)(3)(i) of this section, and any other information required by the IRS in forms, instructions, or other guidance. If a partner is an S corporation, the partnership must also disclose to the IRS information about each shareholder of the S corporation that was a shareholder at any time during the taxable year of the S corporation ending with or within the partnership's taxable year, including each shareholder's name and correct TIN (or alternative form of identification as prescribed by forms, instructions, or other guidance), each shareholder's Federal tax classification, and any other information required by the IRS in forms, instructions, or other guidance.

(3) *Partner notification*. A partnership that makes an election under this section must notify each of its partners of the election within 30 days of making the election in the form and manner determined by the partnership.

(d) *Election made by a partnership that is a partner*–(1) *In general*. The fact that a partnership has made an election under this section does not affect whether the provisions of subchapter C of chapter 63 apply to any other partnership, including a partnership in which the partnership making the election is a partner. Accordingly, the provisions of subchapter C of chapter 63 that apply to partners in a partnership that has not made an election under this section apply, to the extent provided in the regulations under subchapter C of chapter 63, to partners (that are themselves partnerships that have made an election under this section) in their capacity as partners in the other partnership.

(2) *Examples*. The following examples illustrate the rules of paragraph (d)(1) of this section. For purposes of these examples, each partnership is required to file a return under section 6031(a):

Example 1. During its 2020 taxable year, Partnership, a calendar year taxpayer, has two partners. One partner, A, is also a calendar year partnership. A files a valid election under this section with its timely filed partnership return for its 2020 taxable year. Partnership does not file an election under this section. Notwithstanding A's valid election under this section, with respect to A's interest in Partnership, A is subject to the rules applicable to partners in a partnership subject to the rules under subchapter C of chapter 63, including the consistency requirements of section 6222 and the regulations thereunder.

Example 2. The facts are the same as *Example 1* of this paragraph (d)(2). The IRS mails to Partnership a notice of final partnership adjustment under section 6231 with respect to Partnership's 2020 taxable year. Partnership timely elects the alternative to payment of imputed underpayment under section 6226 and the regulations thereunder. Partnership must provide A with a statement under section 6226 reflecting A's share of the adjustments for Partnership's 2020 taxable year. A is subject to the rules applicable to partners in a partnership subject to the rules under subchapter C of chapter 63 with respect to A's interest in Partnership.

(e) *Effect of an election*—(1) *In general*. An election made under this section is an action taken under subchapter C of chapter 63 by the partnership for purposes of section 6223. Accordingly, the partnership and all partners are bound by an election of the partnership under this section unless the IRS determines that the election is invalid. See § 301.6223–2 for the binding nature of actions taken by a partnership under subchapter C of chapter 63.

(2) *IRS determination that election is invalid*. If the IRS determines that an election under this section for a partnership taxable year is invalid, the IRS will notify the partnership in writing and the provisions of subchapter C of chapter 63 will apply to that partnership taxable year.

(f) *Applicability date*. These regulations are applicable to partnership taxable years beginning after December 31, 2017.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: December 22, 2017.

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Part III. Administrative, Procedural, and Miscellaneous

Guidance Under Section 965

Notice 2018–07

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury ("Treasury Department") and the Internal Revenue Service ("IRS") intend to issue regulations for determining amounts included in gross income by a United States shareholder under section 951(a)(1) by reason of section 965 of the Internal Revenue Code ("Code") as amended by "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," P.L. 115–97 (the "Act"), which was enacted on December 22, 2017. Section 2 of this notice provides background on section 965. Section 3 of this notice describes regulations that the Treasury Department and the IRS intend to issue. Section 4 of this notice describes the effective dates of those regulations. Section 5 of this notice requests comments and provides contact information.

SECTION 2. BACKGROUND

.01 Treatment of Accumulated Post-1986 Deferred Foreign Income as Subpart F Income

Section 965(a) provides that for the last taxable year of a deferred foreign income corporation ("DFIC") that begins before January 1, 2018 (such year of the DFIC, the "inclusion year"), the subpart F income of the corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of (1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or (2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017 (each such date, a "measurement date," and the greater of the accumulated post-1986 deferred foreign income of the corporation as of the measurement dates, the "section 965(a) earnings amount"). Furthermore, under section 965(b)(1), the section 965(a) earnings amount which would otherwise be taken into account under section 951(a)(1) by a United States shareholder with respect to a DFIC is reduced by the amount of such United States shareholder's aggregate foreign E&P deficit which is allocated to such DFIC under section 965(b)(2). The section 965(a) earnings amount reduced as described in the preceding sentence is referred to in this notice as the "section 965(a) inclusion amount." Neither the section 965(a) earnings amount nor the section 965(a) inclusion amount is subject to the rules or limitations in section 952 or limited by the accumulated earnings and profits of the DFIC on the date of the inclusion.

.02 Application of the Participation Exemption

Section 965(c)(1) provides that there shall be allowed as a deduction for the taxable year of a United States shareholder in which a section 965(a) inclusion amount is included in the gross income of such United States shareholder an amount equal to the sum of (A) the United States shareholder's 8 percent rate equivalent percentage (as defined in section 965(c)(2)(A)) of the excess (if any) of (i) the section 965(a) inclusion amount, over (ii) the amount of such United States shareholder's aggregate foreign cash position, plus (B) the United States shareholder's 15.5 percent rate equivalent percentage (as defined in section 965(c)(2)(B)) of so much of such United States shareholder's aggregate foreign cash position as does not exceed the section 965(a) inclusion amount.

Section 965(c)(3)(A) provides that the term "aggregate foreign cash position" means, with respect to any United States shareholder, the greater of (i) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the inclusion year, or (ii) one half of the sum of (I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation that ends before November 2, 2017, plus (II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I). Each date referred to in the preceding sentence is referred to in this notice as a "cash measurement date."

The cash position of any specified foreign corporation is the sum of (i) cash held by such corporation, (ii) the net accounts receivable of such corporation, and (iii) the fair market value of the following assets held by such corporation: (I) personal property which is of a type that is actively traded and for which there is an established financial market ("actively traded property"); (II) commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign government; (III) any foreign currency; (IV) any obligation with a term of less than one year ("short-term obligation"); and (V) any asset which the Secretary identifies as being economically equivalent to any asset described in section 965(c)(3)(B). Section 965(c)(3)(B). Also, for purposes of section 965(c), the term "net accounts receivable" means, with respect to any specified foreign corporation, the excess (if any) of (i) such corporation's accounts receivable, over (ii) such corporation's accounts payable (determined consistent with the rules of section 461). Section 965(c)(3)(C).

Section 965(c)(3)(D) provides that net accounts receivable, actively traded property, and short-term obligations shall not be taken into account by a United States shareholder in determining its aggregate foreign cash position to the extent that such United States shareholder demonstrates to the satisfaction of the Secretary that such amount is so taken into account by such United States shareholder with respect to another specified foreign corporation.

Section 965(c)(3)(F) provides that if the Secretary determines that a principal purpose of any transaction was to reduce the aggregate foreign cash position taken into account under section 965(c), such transaction shall be disregarded for purposes of section 965(c).

.03 Definition of DFIC and Accumulated Post-1986 Deferred Foreign Income

For purposes of section 965, a DFIC is, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder that has accumulated post-1986 deferred foreign income (as of a measurement date) greater than zero. Section 965(d)(1). The term "accumulated post-1986 deferred foreign income" means the post-1986 earnings and profits of the specified foreign corporation except to the extent such earnings and profits (A) are attributable to income of the specified foreign corporation that is effectively connected with the conduct of a trade or business within the United States and subject to tax under Chapter 1 ("effectively connected income"), or (B) in the case of a controlled foreign corporation ("CFC"), if distributed, would be excluded from the gross income of a United States shareholder under section 959 ("previously taxed income"). Section 965(d)(2).

Section 965(d)(2) further provides that, to the extent provided in regulations or other guidance prescribed by the Secretary, in the case of any CFC that has shareholders that are not United States shareholders, accumulated post-1986 deferred foreign income shall be appropriately reduced by amounts which would be previously taxed income if such shareholders were United States shareholders.

Section 965(d)(3) provides that the term "post-1986 earnings and profits" means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by only taking into account periods when the foreign corporation was a specified foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined (A) as of the measurement date that is applicable with respect to such foreign corporation, and (B) without diminution by reason of dividends distributed during the inclusion year other than dividends distributed to another specified foreign corporation. Accordingly, under section 965(d)(3)(B), dividends paid by a specified foreign corporation in the inclusion year before a measurement date generally reduce the post-1986 earnings and profits of the corporation as determined on such measurement date, except for dividends paid to a person other than a specified foreign corporation (for example, a United States shareholder).

.04 Specified Foreign Corporation

Section 965(e)(1) provides that the term "specified foreign corporation" means (A) any CFC, and (B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (10- percent corporation). For purposes of sections 951 and 961, a 10-percent corporation is treated as a CFC solely for purposes of taking into account the subpart F income of such corporation under section 965(a). Section 965(e)(2). However, if a passive foreign investment company (as defined in section 1297) with respect to the shareholder is not a CFC, then such corporation is not a specified foreign corporation. Section 965(e)(3).

.05 Determinations of Pro Rata Share

Section 965(f)(1) provides that the determination of any United States shareholder's pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a CFC).

.06 Regulations or Other Guidance

Section 965(o) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of section 965, including regulations or other guidance to provide appropriate basis adjustments, and regulations or other guidance to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.

SECTION 3. REGULATIONS TO BE ISSUED ADDRESSING THE APPLICATION OF SECTION 965

.01 Determination of Aggregate Foreign Cash Position

(a) *Allocation Between Multiple Inclusion Years*

The Treasury Department and the IRS are aware that in cases where specified foreign corporations have inclusion years that end in or with different taxable years of the same United States shareholder, section 965 could result in double-counting such shareholder's aggregate foreign cash position for purposes of determining the shareholder's deduction under section 965(c). For example, assume USP, a calendar year taxpayer, wholly owns CFC1, which has an inclusion year ending December 31, 2017, and CFC2, which has an inclusion year ending November 30, 2018. In addition, assume that USP's pro rata share of the cash position of each of CFC1 and CFC2 on all relevant cash measurement dates is $100, with the result that USP's aggregate foreign cash position is $200. Under section 965(c), the amount allowed as a deduction in the taxable year of a United States shareholder for which the United States shareholder takes a section 965(a) inclusion amount into gross income is based on the aggregate foreign cash position of the United States shareholder. One interpretation of section 965(c) could result in the 15.5 percent rate equivalent percentage applying to as much as $400 of the aggregate section 965(a) inclusion amounts of CFC1 and CFC2 taken into account by USP, because USP's aggregate foreign cash position for its 2017 taxable year (in which CFC1's section 965(a) inclusion amount is taken into account) is $200 and its aggregate foreign cash position for its 2018 taxable year (in which CFC2's section 965(a) inclusion amount is taken into account) is also $200.

The Treasury Department and the IRS intend to issue regulations providing that in the case of a United States shareholder that has a section 965(a) inclusion amount in more than one taxable year, the aggregate foreign cash position taken into account in the first taxable year will equal the lesser of the United States shareholder's aggregate foreign cash position or the aggregate of the section 965(a) inclusion amounts taken into account by the United States shareholder in that taxable year. Furthermore, the amount of the United States shareholder's aggregate foreign cash position taken into account in any succeeding taxable year will be its aggregate foreign cash position reduced by the amount of its aggregate foreign cash position taken into account in any preceding taxable year.

Example. (i) *Facts*. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP is a calendar year taxpayer. CFC1's inclusion year ends December 31, 2017, and CFC2's inclusion year ends November 30, 2018. The cash position of each of CFC1 and CFC2 on all relevant cash measurement dates is $200, with the result that USP has an aggregate foreign cash position of $400. For its 2017 taxable year, USP takes into account CFC1's section 965(a) inclusion amount of $300, and for its 2018 taxable year, USP takes into account CFC2's section 965(a) inclusion amount of $300.

(ii) *Analysis*. USP's aggregate foreign cash position taken into account in 2017 is $300, the lesser of USP's aggregate foreign cash position ($400) or the section 965(a) inclusion amount ($300) that USP takes into account in 2017. The amount of USP's aggregate foreign cash position taken into account in 2018 is $100, USP's aggregate foreign cash position ($400) reduced by the amount of its aggregate foreign cash position taken into account in 2017 ($300).

In addition, in cases in which, for example, a calendar year United States shareholder owns specified foreign corporations with inclusion years that end in or with different taxable years of the United States shareholder, at least one specified foreign corporation of such United States shareholder will have a final cash measurement date in 2017 (for example, December 31, 2017) and at least one other such specified foreign corporation will have a final cash measurement date in 2018 (for example, November 30, 2018). The Treasury Department and the IRS are aware that a United States shareholder in this situation may not be able to determine its aggregate foreign cash position for purposes of calculating its deduction under section 965(c) for its 2017 taxable year by the date that its return for such taxable year must be filed (including extensions).

For purposes of determining the aggregate foreign cash position of a United States shareholder for a taxable year in which it takes into account a section 965(a) inclusion amount, future regulations will provide that the United States shareholder can assume that its pro rata share of the cash position of any specified foreign corporation with an inclusion year ending after the date the return for such taxable year of such United States shareholder is timely filed (including extensions, if any) will be zero as of the cash measurement date with which the inclusion year ends. If a United States shareholder's pro rata share of the cash position of a specified foreign corporation was treated as zero pursuant to the preceding sentence, and the amount described in section 965(c)(3)(A)(i) in fact exceeds the amount described in section 965(c)(3)(A)(ii) with respect to such United States shareholder, the United States shareholder must make appropriate adjustments to reflect that the 15.5 percent rate equivalent percentage applies to a greater amount of the aggregate section 965(a) inclusion amounts taken into account. The Treasury Department and the IRS expect to issue future guidance regarding the appropriate method for making such an adjustment.

Example. (i) *Facts*. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP is a calendar year taxpayer. CFC1's inclusion year ends December 31, 2017, and CFC2's inclusion year ends November 30, 2018. The cash position of CFC1 on each of December 31, 2015, December 31, 2016, and December 31, 2017, is $100. The cash position of CFC2 on each of November 30, 2015, and November 30, 2016, is $200. CFC1 has a section 965(a) inclusion amount.

(ii) *Analysis*. In determining its aggregate foreign cash position for its 2017 taxable year, USP may assume that its pro rata share of the cash position of CFC2 will be zero as of November 30, 2018, for purposes of filing its U.S. federal income tax return due on April 15, 2018 (or due on October 15, 2018, with extension). Therefore, USP's aggregate foreign cash position is treated as $300, which is the greater of (a) $300, 50% of the sum of USP's pro rata shares of the cash position of CFC1 as of December 31, 2015, and December 31, 2016, and of the cash position of CFC2 as of November 30, 2015, and November 30, 2016, and (b) $100, USP's pro rata share of the cash position of CFC1 as of December 31, 2017. If USP's pro rata share of the cash position of CFC2 as of November 30, 2018, in fact exceeds $200, which would result in USP's aggregate foreign cash position being greater than $300, USP must make appropriate adjustments to reflect a higher aggregate foreign cash position, under future guidance to be issued by the Treasury Department and the IRS.

(b) *Treatment of Related-Party Transactions for Purposes of Determination of Cash Position*

Net accounts receivables and short-term obligations between related specified foreign corporations may inflate the aggregate foreign cash position of a United States shareholder relative to the actual aggregate amount of liquid assets (other than the intercompany receivables) owned by the specified foreign corporations of the United States shareholder. For example, if a United States shareholder wholly owns two specified foreign corporations and one specified foreign corporation makes a short-term loan to the other specified foreign corporation, the borrowing corporation may invest the proceeds of such financing in illiquid assets or may spend the cash on operating expenses. The resulting intercompany receivable would be included in the United States shareholder's aggregate foreign cash position, notwithstanding that, if the specified foreign corporations were treated as a single corporation, the liquid assets of the specified foreign corporations would have been reduced by the amount of the borrowed proceeds.

Accordingly, for purposes of determining the cash position of a specified foreign corporation with respect to net accounts receivable and short-term obligations, the Treasury Department and the IRS intend to issue regulations providing that, with respect to a United States shareholder, any receivable or payable of a specified foreign corporation from or to a related specified foreign corporation will be disregarded to the extent of the common ownership of such specified foreign corporations by the United States shareholder. For this purpose, a specified foreign corporation will be treated as related to another specified foreign corporation to the extent that the specified foreign corporations are related persons within the meaning of section 954(d)(3), substituting the term "specified foreign corporation" for "controlled foreign corporation" in each place that it appears.

(c) *Treatment of Derivative Financial Instruments and Hedging Transactions for Purposes of Determination of Cash Position*

Under section 965(c)(3)(B)(iii)(V), the Secretary may identify any asset as being economically equivalent to any asset described in section 965(c)(3)(B). The Treasury Department and the IRS intend to issue regulations that address the treatment of derivative financial instruments for purposes of measuring the cash position of a specified foreign corporation. Derivative financial instruments include notional principal contracts, options contracts, forward contracts, futures contracts, short positions in securities and commodities, and any similar financial instruments. These regulations will provide that the cash position of any specified foreign corporation will include the fair market value of each derivative financial instrument held by the specified foreign corporation that is not a "bona fide hedging transaction" (as defined in this section 3.01(c)). The Treasury Department and the IRS are considering whether future guidance should exclude derivative financial instruments that are not actively traded or that do not reference an asset described in section 965(c)(3)(B) (a "cash-equivalent asset") from the definition of cash position. The value of each derivative financial instrument that must be taken into account in determining the cash position of a specified foreign corporation may be positive or negative; however, the aggregate amount taken into account for all derivative financial instruments (excluding bona fide hedging transactions) of a specified foreign corporation cannot be less than zero. Furthermore, derivative financial instruments between related specified foreign corporations will be disregarded on the same terms as receivables and payables described in section 3.01(b) of this notice.

For purposes of this section 3.01(c), a bona fide hedging transaction means a hedging transaction that meets the requirements of a bona fide hedging transaction described in § 1.954–2(a)(4)(ii) and that is properly identified as such in accordance with the requirements of that subparagraph. Consistent with the definition of a bona fide hedging transaction in § 1.954–2(a)(4)(ii), in the case of an asset hedging transaction, the risk being hedged may be with respect to ordinary property, section 1231 property, or a section 988 transaction. Because the identification requirements of § 1.954–2(a)(4)(ii) are generally relevant only to CFCs whereas section 965 applies to all specified foreign corporations, the Treasury Department and the IRS will provide guidance in the future on identifying bona fide hedging transactions of specified foreign corporations that are not CFCs.

If a derivative financial transaction is a bona fide hedging transaction that is used to hedge a cash-equivalent asset, the value of the cash-equivalent asset identified on the taxpayer's books and records as the asset being hedged must be adjusted by the fair market value of the bona fide hedging transaction that is used to hedge such cash-equivalent asset (such hedging transaction, a "cash-equivalent asset hedging transaction"). The value of a cash-equivalent asset hedging transaction must be taken into account in determining the cash position of a specified foreign corporation whether the cash-equivalent asset hedging transaction has positive or negative value, but only to the extent that the cash-equivalent asset hedging transaction (or transactions) does not reduce the fair market value of the asset being hedged below zero.

Finally, a bona fide hedging transaction with respect to an asset that is not a cash-equivalent asset or with respect to a liability (as described in § 1.1221–2(b)(2)) is not included in a specified foreign corporation's cash position for purposes of section 965(c)(3)(B).

.02 Determination of Accumulated Post-1986 Deferred Foreign Income

(a) *Adjustments to Post-1986 Earnings and Profits to Account for Certain Amounts Paid or Incurred Between Specified Foreign Corporations Between Measurement Dates*

Certain transactions between specified foreign corporations may result in earnings and profits of a specified foreign corporation being taken into account more than once or not at all by a United States shareholder under section 965(a). In this regard, the Conference Report accompanying the Act states:

> In order to avoid double-counting and double non-counting of earnings, the Secretary may provide guidance to adjust the amount of post-1986 earnings and profits of a specified foreign corporation to ensure that a single item of a specified foreign corporation is taken into account only once in determining the income of a United States shareholder subject to this provision. Such an adjustment may be necessary, for example, when there is a deductible payment (e.g., interest or royalties) from one specified foreign corporation to another specified foreign corporation between measurement dates.

H.R. Rep. No. 115–466, at 619 (2017). Consistent with congressional intent, the Treasury Department and the IRS intend to issue regulations to address the possibility of double-counting or double non-counting in the computation of post-1986 earnings and profits arising from amounts paid or incurred (including certain dividends) between related specified foreign corporations of a United States shareholder that occur between measurement dates and that would otherwise reduce the post-1986 earnings and profits as of December 31, 2017, of the specified foreign corporation that paid or incurred such amounts. For purposes of this section 3.02(a), the term "related" has the same meaning as given in section 3.01(b) of this notice.

The following examples illustrate fact patterns involving double-counting or double non-counting that will be addressed by future regulations.

Example 1. (i) *Facts*. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP, CFC1, and CFC2 have calendar year taxable years. On November 2, 2017, each of CFC1 and CFC2 has post-1986 earnings and profits of 100u. Neither CFC1 nor CFC2 has previously taxed income or effectively connected income for any taxable year, and therefore each of CFC1's and CFC2's accumulated post-1986 deferred foreign income is equal to such corporation's post-1986 earnings and profits. On November 3, 2017, CFC2 makes a deductible payment of 10u to CFC1. The payment does not constitute subpart F income. CFC1 and CFC2 have no other items of income or deduction.

(ii) *Analysis*. Absent any adjustments, on December 31, 2017, CFC1 has post-1986 earnings and profits of 110u (100u plus 10u income from the deductible payment), and CFC2 has post-1986 earnings and profits of 90u (100u minus 10u deductible expense). The section 965(a) earnings amount with respect to CFC1 would be 110u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 110u accumulated post-1986 deferred foreign income on December 31, 2017, and the section 965(a) earnings amount with respect to CFC2 would be 100u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 90u accumulated post-1986 deferred foreign income on December 31, 2017. Disregarding the intercompany deductible payment, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 200u. However, taking the deductible payment into account, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 210u, because the 10u of income from the deductible payment would increase the post-1986 earnings and profits of CFC1 as of December 31, 2017, but the 10u of deductible expense would not decrease the post-1986 earnings and profits of CFC2 as of November 2, 2017. Under regulations to be issued by the Treasury Department and the IRS, an adjustment would be made with the result that CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 200u.

Example 2. (i) *Facts*. Assume the same facts as in *Example 1*, except instead of a deductible payment to CFC1, CFC2 makes a 10u distribution on November 3, 2017. The distribution increases CFC1's post-1986 earnings and profits as of December 31, 2017, by 10u and reduces CFC2's post-1986 earnings and profits as of December 31, 2017, by the same amount under section 965(d)(3)(B).

(ii) *Analysis*. Similar to the analysis in *Example 1*, the section 965(a) earnings amount with respect to CFC1 would be 110u, and the section 965(a) earnings amount with respect to CFC2 would be 100u, resulting in aggregate section 965(a) earnings amounts of 210u. Under regulations to be issued by the Treasury Department and the IRS, an adjustment would be made with the result that CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 200u. For an additional rule relating to dividends paid by one specified foreign corporation to another specified foreign corporation, see section 3.02(b) of this notice.

Example 3. (i) *Facts*. Assume the same facts as in *Example 1*, except that CFC2 does not make a deductible payment to CFC1, and, between measurement dates, CFC2 accrues gross income of 20u from a person that is not related to CFC2, and CFC1 incurs a deductible expense of 20u to a person that is not related to CFC1.

(ii) *Analysis*. Absent any adjustments, on December 31, 2017, CFC1 has post-1986 earnings and profits of 80u (100u minus 20u deductible expense), and CFC2 has post-1986 earnings and profits of 120u (100u plus 20u gross income). The section 965(a) earnings amount with respect to CFC1 would be 100u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 80u accumulated post-1986 deferred foreign income on December 31, 2017, and the section 965(a) earnings amount with respect to CFC2 would be 120u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 120u accumulated post-1986 deferred foreign income on December 31, 2017. CFC1 and CFC2 have, in the aggregate, section 965(a) earnings amounts of 220u. The section 965(a) earnings amounts, in the aggregate, are 20u greater than in *Example 1*, notwithstanding that CFC1 and CFC2 have, in the aggregate, earned no additional income. However, the additional 20u of section 965(a) earnings amount does not arise from an amount paid or incurred between specified foreign corporations that are related. The regulations to be issued by the Treasury Department and the IRS will not adjust the aggregate section 965(a) earnings amounts of CFC1 and CFC2.

Example 4. (i) *Facts*. Assume the same facts as in *Example 3*, except that CFC2 also makes a deductible payment of 10u to CFC1 on November 3, 2017.

(ii) *Analysis*. Absent any adjustments, on December 31, 2017, CFC1 has post-1986 earnings and profits of 90u (100u minus 20u deductible expense plus 10u intercompany income from the deductible payment), and CFC2 has post-1986 earnings and profits of 110u (100u plus 20u gross income minus10u intercompany deductible expense). The section 965(a) earnings amount with respect to CFC1 would be 100u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 90u accumulated post-1986 deferred foreign income on December 31, 2017, and the section 965(a) earnings amount with respect to CFC2 would be 110u, the greater of 100u accumulated post-1986 deferred foreign income on November 2, 2017, and 110u accumulated post-1986 deferred foreign income on December 31, 2017. Taking the intercompany deductible payment into account, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 210u, because the 10u of income from the deductible payment would not increase the post-1986 earnings and profits of CFC1 as of November 2, 2017, but the 10u of deductible expense would decrease the post-1986 earnings and profits of CFC2 as of December 31, 2017. However, disregarding the intercompany deductible payment, CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 220u. Under regulations to be issued by the Treasury Department and the IRS, an adjustment would be made with the result that CFC1 and CFC2 would have, in the aggregate, section 965(a) earnings amounts of 220u.

(b) *Determination of Amount of Diminution by Reason of Distributions to Specified Foreign Corporations*

The post-1986 earnings and profits of a specified foreign corporation are reduced to reflect dividends distributed during the corporation's inclusion year to another specified foreign corporation ("the dividend reduction rule"). Section 965(d)(3)(B). As a result, a dividend paid by a specified foreign corporation to another specified foreign corporation (whether in an inclusion year or a prior taxable year, including a prior taxable year that includes a measurement date) generally reduces the corporation's post-1986 earnings and profits with respect to any measurement date that such dividend precedes.

The dividend reduction rule is intended to address the potential double-counting of the earnings and profits of the distributing specified foreign corporation in calculating the section 965(a) inclusion amounts taken into account by a United States shareholder with respect to the distributing specified foreign corporation and the distributee specified foreign corporation. (See *Example 2* in section 3.02(a) of this notice illustrating double-counting arising from dividends paid between measurement dates notwithstanding the application of the dividend reduction rule.) To the extent that a portion of a distribution reduces the post-1986 earnings and profits of a distributing specified foreign corporation (for example, by reason of a reduction pursuant to section 312(a)(3)) in an amount in excess of the increase in the post-1986 earnings and profits of the distributee specified foreign corporation, such reduction would not relieve double-counting and thus would be inconsistent with the purpose of the rule.

Accordingly, the Treasury Department and the IRS intend to issue regulations to clarify that the amount by which the post-1986 earnings and profits of a specified foreign corporation is reduced under section 965(d)(3)(B) as a result of a distribution made to a specified foreign corporation in the inclusion year may not exceed the amount by which the post-1986 earnings and profits of the distributee corporation is increased as a result of the distribution.

(c) *Determination of Accumulated Post-1986 Deferred Foreign Income in the Case of a Controlled Foreign Corporation with Non-United States Shareholders*

In the case of a CFC that has shareholders that are not United States shareholders on a measurement date, the Treasury Department and the IRS intend to issue regulations providing that the accumulated post-1986 deferred foreign income of the CFC on such measurement date will be reduced by amounts that would be described in section 965(d)(2)(B) if such shareholders were United States shareholders. In such cases, the regulations will follow the principles of Revenue Ruling 82–16, 1982–1 C.B. 106, in order to determine the amounts by which accumulated post-1986 deferred foreign income is reduced.

Example. (i) *Facts*. USP, a domestic corporation, and FP, a foreign corporation unrelated to USP, have owned 70% and 30% respectively, by vote and value, of the only class of stock of FS, a foreign corporation, from January 1, 2016, until December 31, 2017. USP and FS both have a calendar year taxable year. FS had no income until its taxable year ending December 31, 2016, in which it had 100u of income, all of which constituted subpart F income, and USP included 70u in income with respect to FS under section 951(a)(1) for such year. FS earned no income in 2017. Therefore, FS's post-1986 earnings and profits are 100u as of both of the measurement dates.

(ii) *Analysis*. Because USP included 70u in income with respect to FS under section 951(a)(1), 70u of such post-1986 earnings and profits is previously taxed income and, if distributed, would be excluded from the gross income of USP under section 959. Thus, FS's accumulated post-1986 deferred foreign income would be reduced by 70u pursuant to section

965(d)(2)(B). Furthermore, the accumulated post-1986 deferred foreign income of FS is reduced by amounts that would be described in section 965(d)(2)

(B) if FP were a United States shareholder, consistent with the principles of Revenue Ruling 82–16. Accordingly, FS's accumulated post-1986 deferred foreign income would be reduced by the remaining 30u of the 100u of post-1986 earnings and profits to which USP's 70u of section 951(a)(1) income inclusions were attributable. Accordingly, FS's accumulated post-1986 deferred foreign income is 0u (100u minus 70u minus 30u).

(d) *Coordination Between Sections 959 and 965 in the Inclusion Year*

The accumulated post-1986 deferred foreign income of a specified foreign corporation that is a CFC excludes earnings to the extent that they would, if distributed, be excluded from the gross income of a United States shareholder under section 959 (that is, previously taxed income). Section 965(d)(2)(B). Post-1986 earnings and profits of a specified foreign corporation are determined without diminution by reason of dividends distributed during the inclusion year, other than dividends distributed to another specified foreign corporation. Section 965(d)(3)(B).

In general, earnings and profits of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) are not again included in the gross income of such United States shareholder when distributed (or when they would but for section 959(a) be included under section 951(a)(1)(B)). Section 959(a). For purposes of applying section 959(a), a distribution from a foreign corporation is treated as attributable first to earnings and profits included in gross income under section 951(a)(1)(B), then to earnings and profits included in gross income under section 951(a)(1)(A), and then to other earnings and profits. Section 959(c). A distribution excluded from gross income under section 959(a) is treated, for purposes of Chapter 1, as a distribution which is not a dividend, except that such distributions immediately reduce earnings and profits. Section 959(d). Actual distributions are taken into account before amounts that would be included under section 951(a)(1)(B). Section 959(f)(2).

The Treasury Department and the IRS intend to issue regulations to clarify the interaction between the rules under sections 959 and 965 in the inclusion year of a DFIC and the taxable year of a United States shareholder of the DFIC in which or with which such inclusion year ends. Such regulations will describe the following steps for determining the section 965(a) inclusion amount of a DFIC, the treatment of distributions under section 959, and the amount of an inclusion under sections 951(a)(1)(B) and 956 with respect to a DFIC:

(1) First, the subpart F income of the DFIC is determined without regard to section 965(a), and the United States shareholder's inclusion under section 951(a)(1)(A) by reason of such amount is taken into account.
(2) Second, the treatment of a distribution from the DFIC to another specified foreign corporation that is made before January 1, 2018, is determined under section 959.
(3) Third, the section 965(a) inclusion amount of the DFIC is determined, and the United States shareholder's inclusion under section 951(a)(1)(A) by reason of such amount is taken into account.
(4) Fourth, the treatment of all distributions from the DFIC other than those described in step 2 is determined under section 959.
(5) Fifth, an amount is determined under section 956 with respect to the DFIC and the United States shareholder, and the United States shareholder's inclusion under section 951(a)(1)(B) is taken into account.

Example. (i) *Facts*. USP, a domestic corporation, owns all of the stock of CFC1, a foreign corporation, which owns all of the stock of CFC2, also a foreign corporation. USP, CFC1, and CFC2 all have taxable years ending December 31, 2017. As of January 1, 2017, CFC1 has no earnings and profits, and CFC2 has 100u of earnings and profits described in section 959(c)(3) that were accumulated in taxable years beginning after December 31, 1986, while CFC2 was a specified foreign corporation. On March 1, 2017, CFC1 earns 30u of subpart F income (as defined in section 952), and CFC2 earns 20u of subpart F income. On July 1, 2017, CFC2 distributes 40u to CFC1, and the exception described in section 954(c)(6)(A) applies to such distribution. On November 1, 2017, CFC1 distributes 60u to USP.

(ii) *Analysis*. (A) *Application of section 959 without regard to section 965*. USP determines its inclusion under section 951(a)(1)(A) without regard to section 965(a), which is 30u with respect to CFC1 and 20u with respect to CFC2 for their taxable years ending December 31, 2017. As a result of the inclusions under section 951(a)(1)(A), CFC1 and CFC2 increase their earnings and profits described in section 959(c)(2) by 30u and 20u, respectively.

(B) *Distributions between specified foreign corporations before January 1, 2018*. The distribution of 40u from CFC2 to CFC1 is treated as a distribution of 20u out of earnings and profits described in section 959(c)(2) (attributable to inclusions under section 951(a)(1)(A) that are not by reason of section 965(a)) and 20u out of earnings and profits described in section 959(c)(3).

(C) *Section 965(a) inclusion amount*. USP determines CFC1's and CFC2's section 965(a) inclusion amounts. Because there are no aggregate foreign E&P deficits to be allocated to CFC1 and CFC2, the section 965(a) inclusion amount of CFC1 and CFC2 equals the section 965(a) earnings amount with respect to CFC1 and CFC2, respectively.

(*1*) *CFC1 section 965(a) earnings amount*. The section 965(a) earnings amount with respect to CFC1 is 20u, the amount of its accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017, which is equal to 70u of post-1986 earnings and profits (30u earned and 40u attributable to the CFC2 distribution) reduced by 50u of previously taxed income described in section 959(c)(2) (30u earned and 20u attributable to the CFC2 distribution) under section 965(d)(2)(B). Under section 965(d)(3)(B), the post-1986 earnings and profits of CFC1 are not reduced by the 60u distribution to USP.

(*2*) *CFC2 section 965(a) earnings amount*. The section 965(a) earnings amount with respect to CFC2 is 80u, the amount of its accumulated post-1986 deferred foreign income as of both November 2, 2017, and December 31, 2017, which is equal to the amount of CFC2's post-1986 earnings and profits of 80u. For purposes of calculating CFC2's accumulated post-1986 deferred foreign income, CFC2 has no previously taxed income and therefore no adjustment is made under section 965(d)(2)(B). CFC2's 80u of post-1986 earnings and profits consists of 120u of earnings and profits that it earned, reduced by the 40u distribution to CFC1 under section 965(d)(3)(B). The amount of the reduction to the post-1986 earnings and profits of CFC2 for the 40u distribution is not limited by the rules described in section 3.02(b) of this notice because CFC1's post-1986 earnings and profits are increased by 40u as a result of the distribution. Furthermore, because the 40u distribution was made on July 1, 2017, which is prior to any measurement date, section 3.02(a) of this notice is not relevant.

(*3*) *Effect on previously taxed income*. CFC1 and CFC2 increase their previously taxed income described in section 959(c)(2) by their section 965(a) inclusion amounts taken into account by USP, 20u and 80u, respectively, and reduce their earnings and profits described in section 959(c)(3) by an equivalent amount.

(D) *Distribution to United States shareholder*. The distribution from CFC1 to USP is treated as a distribution of 60u out of the earnings and profits of

CFC1 described in section 959(c)(2), which include earnings and profits attributable to the section 965(a) inclusion amount taken into account by USP.

.03 Application of Section 961 to Amounts Treated as Subpart F Income Under Section 965

Section 965(o) authorizes the Treasury Department and the IRS to issue regulations or other guidance to provide appropriate basis adjustments in order to carry out the provisions of section 965. In order to provide certainty regarding the application of the rules described in section 961 with respect to amounts included under section 965, the Treasury Department and the IRS intend to issue regulations providing that if a United States shareholder receives distributions from a DFIC during the inclusion year that are attributable to previously taxed income described in section 959(c)(2) by reason of section 965(a), the amount of gain recognized by the United States shareholder with respect to the stock of the DFIC under section 961(b)(2) will be reduced (but not below zero) by the section 965(a) inclusion amount.

.04 Treatment of Affiliated Group Making a Consolidated Return For Purposes of Section 965

Pursuant to the Secretary's authority under sections 965(o) and 1502, the Treasury Department and the IRS intend to issue regulations providing that, solely with respect to the calculation of the amount included in gross income by a consolidated group (as defined in § 1.1502–1(h)) under section 951(a)(1) by reason of section 965(a), all of the members of a consolidated group that are United States shareholders of one or more specified foreign corporations will be treated as a single United States shareholder. Thus, for example, all members of a consolidated group that are United States shareholders will be treated as a single United States shareholder for purposes of determining the aggregate foreign cash position of the consolidated group and for purposes of taking such aggregate foreign cash position into account under section 965(c)(1).

These regulations will provide that, consistent with the consolidated return regulations (and notwithstanding the calculation of the amount described in the prior paragraph), appropriate adjustments, for example, adjustments under § 1.1502–32 to the basis of the stock of each member that is a United States shareholder, will be made to reflect the impact of amounts included in gross income under section 951(a)(1) by reason of section 965(a), and the impact of other attributes of each member on this calculation, such as the ownership of E&P deficit foreign corporations by particular members and the cash position of specified foreign corporations held by particular members. These regulations will also provide that taxpayers must make appropriate adjustments reflecting minority ownership interests in a member of the consolidated group that are owned by a person that is not a member of the consolidated group.

.05 Determination of Foreign Currency Gain or Loss under Section 986(c)

The Treasury Department and the IRS intend to issue regulations providing that any gain or loss recognized under section 986(c) with respect to distributions of previously taxed income described in section 959(c)(2) by reason of section 965(a) will be diminished proportionately to the diminution of the taxable income resulting from section 965(a) by reason of the deduction allowed under section 965(c). *See* H.R. Rep. No. 115–466, at 620.

The adjustments with respect to section 986(c) must be made so as to apply solely with respect to distributions of previously taxed income described in section 959(c)(2) by reason of section 965(a). Accordingly, future regulations will also provide ordering rules for determining the portion of a distribution that will be treated as previously taxed income described in section 959(c)(2) by reason of section 965(a).

SECTION 4. EFFECTIVE DATES

Section 965 is effective for the last taxable years of foreign corporations that begin before January 1, 2018, and with respect to United States shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end. The Treasury Department and the IRS intend to provide that the regulations described in section 3 of this notice are effective beginning the first taxable year of a foreign corporation (and with respect to United States shareholders, the taxable years in which or with which such taxable years of the foreign corporations end) to which section 965 applies. Before the issuance of the regulations described in this notice, taxpayers may rely on the rules described in section 3.

SECTION 5. REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments on the rules described in this notice. In addition, the Treasury Department and the IRS expect to issue additional guidance under section 965, and the Treasury Department and the IRS request comments on what additional guidance should be issued to assist taxpayers in applying section 965.

Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Leni C. Perkins, Internal Revenue Service, IR–4549, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to Notice.comments@irscounsel.treas.gov. Comments will be available for public inspection and copying.

The principal author of this notice is Ms. Perkins of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Perkins at (202) 317-6934 (not a toll-free number).

Exclusion of Foreign Currency Gain or Loss Related to Business Needs from Foreign Personal Holding Company Income; Mark-to-Market Method of Accounting for Section 988 Transactions

REG–119514–15

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance on the treatment of foreign currency gain or loss of a controlled foreign corporation (CFC) under the business needs exclusion from foreign personal holding company income (FPHCI). The proposed regulations also provide an election for a taxpayer to use a mark-to-market method of accounting for foreign currency gain or loss attributable to section 988 transactions. In addition, the proposed regulations permit the controlling United States shareholders of a CFC to automatically revoke certain elections concerning the treatment of foreign currency gain or loss. The proposed regulations affect taxpayers and United States shareholders of CFCs that engage in transactions giving rise to foreign currency gain or loss under section 988 of the Internal Revenue Code (Code).

DATES: Written or electronic comments and requests for a public hearing must be received by March 19, 2018.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–119514–15), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–119514–15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–119514–15).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jeffery G. Mitchell, (202) 317-6934; concerning submissions of comments or requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by February 20, 2018.

Comments are specifically requested concerning:

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

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

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

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

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

The collection of information in these proposed regulations is in proposed §§ 1.954–2(g)(3)(iii) and (4)(iii) and 1.988–7. The information is required to be provided by taxpayers and United States shareholders of CFCs that make an election or revoke an election with respect to the treatment of foreign currency gains and losses. The information provided will be used by the IRS for tax compliance purposes.

Estimated total annual reporting burden: 5,000 hours.

Estimated average annual burden hours per respondent: one hour.

Estimated number of respondents: 5,000.

Estimated annual frequency of responses: one.

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

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

Background

This document contains proposed amendments to 26 CFR part 1 under sections 446, 954(c)(1)(D), and 988 of the Code. Section 446 requires taxpayers to compute taxable income using accounting methods that clearly reflect income. Section 954(c)(1)(D) provides that FPHCI includes the excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to section 988 transactions, other than transactions directly related to the business needs of the CFC. Section 988 provides rules for determining the source and character of gain or loss from certain foreign currency transactions.

A. Business Needs Exclusion

1. In general

Section 954 defines foreign base company income (FBCI), which generally is income earned by a CFC that is taken into account in computing the amount that a United States shareholder of the CFC must include in income under section 951(a)(1)(A). Under section 954(a)(1), FBCI includes FPHCI, which is defined in section 954(c). The excess of foreign currency gains over foreign currency losses from section 988 transactions is generally included in FPHCI pursuant to section 954(c)(1)(D).

Section 988 transactions generally include the following: the accrual of any item of income or expense that is to be paid or received in a nonfunctional currency after the date of accrual; lending or borrowing in a nonfunctional currency; entering into or acquiring a forward, future, option, or similar contract denominated in a nonfunctional currency; and the disposition of nonfunctional currency. *See* section 988(c). Thus, accruals in connection with ordinary business transactions, such as purchases and sales of inventory or the provision of services, are section 988 transactions if the receivable or payable is denominated in, or determined by reference to, a currency other than the taxpayer's functional currency, as determined under § 1.985–1.

Notwithstanding the general rule that includes the excess of foreign currency gains over foreign currency losses from section 988 transactions in FPHCI, section 954(c)(1)(D) excludes from FPHCI any foreign currency gain or loss attributable to a transaction directly related to the business needs of the CFC (business needs exclusion). To qualify for the business needs exclusion, a foreign currency gain or loss must, in addition to satisfying other requirements, arise from a transaction entered into, or property used, in the normal course of the CFC's business that does not itself (and could not reasonably be expected to) give rise to subpart F income (as defined in section 952) other than foreign currency gain or loss. *See* § 1.954–2(g)(2)(ii)(B)(*1*).

Foreign currency gain or loss attributable to a bona fide hedging transaction (as defined in § 1.954–2(a)(4)(ii)) with respect to a transaction or property that qualifies for the business needs exclusion also qualifies for the business needs exclusion, provided that any gain or loss with respect to such transaction or property that is attributable to changes in exchange rates is clearly determinable from the records of the CFC as being derived from such property or transaction. *See* § 1.954–2(g)(2)(ii)(B)(*2*). Generally, bona fide hedging transactions are transactions that meet the requirements for a hedging transaction under § 1.1221–2(a) through (d), except that a bona fide hedging transaction also includes a transaction entered into in the normal course of business primarily to manage risk with respect to section 1231 property or a section 988 transaction. Under § 1.1221–2(b), a hedging transaction is defined as a transaction that a taxpayer enters into in the normal course of its trade or business primarily to manage the risk of price changes or currency fluctuations with respect to ordinary property that is held or to be held by the taxpayer, or to manage the risk of interest rate or price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, by the taxpayer. Transactions that manage risks related to assets that would produce capital gain or loss on disposition (capital assets), or assets owned or liabilities owed by a related party, do not qualify as hedging transactions under § 1.1221–2(b). To qualify as a bona fide hedging transaction, the transaction must be clearly identified as a hedging transaction before the end of the day on which the CFC acquired, originated, or entered into the transaction. *See* §§ 1.1221–2(f) and 1.954–2(a)(4)(ii)(A) and (B).

Section 1.954–2(g)(2)(ii)(C) provides special rules for applying the business needs exclusion to CFCs that are regular dealers as defined in § 1.954–2(a)(4)(iv). Transactions in dealer property (as defined in § 1.954–2(a)(4)(v)) that are entered into by a CFC that is a regular dealer in such property in its capacity as a dealer are treated as directly related to the business needs of the CFC. *See* § 1.954–2(g)(2)(ii)(C)(*1*). In addition, an interest–bearing liability denominated in a nonfunctional currency and incurred by a regular dealer is treated as dealer property if it reduces the CFC's currency risk with respect to dealer property and is identified on the CFC's records as a liability treated as dealer property. *See* § 1.954–2(g)(2)(ii)(C)(*2*). A regular dealer is a CFC that regularly and actively offers to, and in fact does, purchase property from and sell property to unrelated customers in the ordinary course of business, or that regularly and actively offers to, and in fact does, enter into, assume, offset, assign or otherwise terminate positions in property with unrelated customers in the ordinary course of business. *See* § 1.954–2(a)(4)(iv).

2. Use of net foreign currency losses

Under section 954(c)(1)(D), although a foreign currency loss that does not qualify for the business needs exclusion reduces the amount of foreign currency gain that is included in FPHCI, an excess of foreign currency losses over foreign currency gains from section 988 transactions generally does not reduce FPHCI. Such a net foreign currency loss does, however, reduce earnings and profits for purposes of the current earnings and profits limitation on subpart F income in section 952(c)(1). Additionally, as described in Part D of this Background section, when an election under § 1.954–2(g)(3) or (4) is in effect, a foreign currency loss can reduce FPHCI or, in the case of an election under § 1.954–2(g)(3), another category of subpart F income.

3. Inapplicability of business needs exclusion to transactions and property that give rise to both subpart F income and non-subpart F income

In order for the business needs exclusion to apply to exclude foreign currency gain and loss from the computation of FPHCI, the foreign currency gain or loss must arise from a transaction or property that does not itself (and could not reasonably be expected to) give rise to any subpart F income other than foreign currency gain or loss. For example, foreign currency gains and losses related to the purchase and sale of inventory are excluded from the computation of FPHCI if none of the income from the purchase and sale is subpart F income under section 952. However, if the transaction or property gives rise to, or could reasonably be expected to give rise to, any amount of subpart F income (other than foreign currency gain or loss), none of the foreign currency gain or loss attributable to the transaction or property would qualify for the business needs exclusion. Thus, there is a cliff effect: if even a de minimis amount of income or gain from the transaction or property is subpart F income, the entire amount of the foreign currency gain or loss from the transaction or property, or from a bona fide hedging transaction with respect to the transaction or property, is included in the FPHCI computation.

4. Transactions that manage the risk of currency fluctuation in a qualified business unit

A CFC may conduct business through a qualified business unit (as defined in § 1.989(a)–1) (QBU) that is not treated as a separate entity for federal income tax purposes, either because it is a branch or division of the CFC or because it is a business entity that is disregarded as separate from its owner. Although the QBU is not treated as a separate entity, it may have a functional currency under § 1.985–1 that is different from that of the CFC owner, with consequences for the determination of foreign currency gain and loss under sections 987 and 988. The QBU's transactions in its own functional currency are not section 988 transactions of the CFC, and accordingly the CFC does not realize foreign currency gain or loss on such transactions. The CFC generally must, however, take into account under section 987 foreign currency gain or loss with respect to the QBU upon remittances from the QBU.

For business and financial accounting reasons, a CFC may enter into transactions to manage the exchange rate risk associated with its net investment in its QBU. Under generally accepted accounting principles in the United States (U.S. GAAP), a majority owner of a business entity (parent corporation) must consolidate the accounts of the majority-owned entity, including a foreign entity, with its own accounts for purposes of financial reporting. Under U.S. GAAP, the income, assets, liabilities, and other financial results of foreign operations that are conducted in a functional currency that differs from the consolidated parent's functional currency must be translated into the functional currency of the consolidated parent. Foreign currency gains or losses arising from the translation are recorded in a "cumulative translation adjustment" account and reported as a component of shareholders' equity on the balance sheet. *See generally* Accounting Standards Codification (ASC) 830–30–45. Foreign currency gain or loss from transactions that effectively hedge the risk of currency fluctuations in the net equity investment in foreign operations also are recorded in the cumulative translation adjustment account. *See* ASC 815–35–35. A cumulative translation adjustment is not taken into account in computing the income of the consolidated group until the relevant operations are disposed of or liquidated.

The transactions that a CFC uses to manage its exchange rate risk with respect to its net investment in a QBU are typically section 988 transactions. Thus, foreign currency gains or losses attributable to those transactions are taken into account in computing FPHCI, unless the transactions qualify as bona fide hedging transactions that satisfy the requirements of the business needs exclusion. *See* § 1.954–2(g)(2)(ii)(B)(*2*). Neither the Code nor the section 954 regulations provide specific guidance on whether a transaction entered into to manage exchange rate risk arising from a CFC's net investment in a QBU can qualify as a bona fide hedging transaction eligible for the business needs exclusion. This issue can be consequential because foreign currency gain, but not loss, from a transaction erroneously identified as a bona fide hedging transaction is included in the computation of FPHCI, unless the CFC qualifies for the inadvertent identification exception. *See* § 1.954–2(a)(4)(ii)(C) and (g)(2)(ii)(B)(*2*). Additionally, even if a transaction entered into to manage exchange rate risk arising from a CFC's net investment in a QBU is eligible for treatment as a bona fide hedging transaction, the transaction would not qualify for the business needs exclusion unless the hedged property did not, and could not reasonably be expected to, give rise to any subpart F income.

Also for business and financial accounting reasons, a CFC may enter into transactions to manage the exchange rate risk with respect to its net investment in a subsidiary CFC. A transaction that manages the risk of price or currency fluctuation with respect to a CFC's net investment in a subsidiary CFC is not considered a hedging transaction for federal income tax purposes. In *Hoover Co. v. Commissioner*, 72 T.C. 706 (1979), the Tax Court held that transactions entered into to manage the risk of a decline in value of a taxpayer's net investment in a foreign subsidiary that might occur if the value of the subsidiary's functional currency declined relative to the U.S. dollar were not hedging transactions for federal income tax purposes. *See also* § 1.1221–2(b) (providing that a hedging transaction must manage risk with respect to "ordinary property . . . that is held or to be held by the taxpayer"). Thus, foreign currency gains and losses on transactions that manage the risk of currency fluctuation on a CFC's net investment in a subsidiary CFC are taken into account in computing FPHCI.

B. Timing of Foreign Currency Gains and Losses

1. Hedge timing rules of § 1.446–4

Section 1.446–4 generally requires gain or loss from a hedging transaction, as defined in § 1.1221–2(b), to be taken into account at the same time as the gain or loss from the item being hedged. As noted in Part A.1 of this Background section, bona fide hedging transactions under § 1.954–2(a)(4)(ii) include both hedging transactions as defined in § 1.1221–2(b) and transactions that manage the risk of price or currency fluctuation with respect to section 1231 property and section 988 transactions. Thus, § 1.446–4 does not explicitly apply to all bona fide hedging transactions, which has led to some uncertainty about whether gain or loss from a bona fide hedging transaction that is not described in § 1.1221–2(b) is properly taken into account in the same taxable year as gain or loss on the hedged item. The Department of the Treasury (Treasury Department) and the IRS understand that some taxpayers have applied the hedge timing rules of § 1.446–4 to all bona fide hedging transactions, irrespective of whether those transactions are hedging transactions as defined in § 1.1221–2(b).

2. Treasury center CFCs

It is common for a U.S.-parented multinational group to own one or more CFCs that serve as financing entities for other group members. Such CFCs (treasury center CFCs) may borrow in various currencies from third party lenders or from other members of the group and lend the proceeds to other members of the group. Treasury center CFCs also may be used to centralize the management of currency and other risks of other CFCs within the multinational group. Treasury center CFCs typically qualify as securities dealers under section 475, but if a treasury center CFC transacts primarily or exclusively with related persons, as is often the case, it would not qualify as a regular dealer under § 1.954–2(a)(4)(iv) and thus would not be eligible for the special rules applying the business needs exclusion to certain transactions of regular dealers under § 1.954–2(g)(2)(ii)(C).

When a treasury center CFC borrows nonfunctional currency from related or unrelated parties and makes loans denominated in that nonfunctional currency to a related CFC, the foreign currency gain or loss attributable to the principal amount borrowed by the treasury center CFC will economically offset all or a portion of the foreign currency loss or gain, respectively, attributable to the lending activity. Similarly, the foreign currency gain or loss attributable to the treasury center CFC's accrual of interest income and expense with respect to its lending and borrowing activities, respectively, will offset each other, in whole or in part. Thus, by borrowing and lending in the same nonfunctional currency, a treasury center CFC is said to be "naturally hedged."

Although the borrowing and lending in the same nonfunctional currency are economically offsetting, section 475 creates the potential for a mismatch of gains and losses for a treasury center CFC. If the treasury center CFC qualifies as a dealer under section 475, for example because it regularly purchases debt from related CFCs in the ordinary course of a trade or business, the treasury center CFC generally must use a mark-to-market method of accounting for its securities. *See* section 475 and §1.475(c)–1(a)(3)(i). However, §1.475(c)–2(a)(2) provides that a dealer's own issued debt liabilities are not securities for purposes of section 475. Consequently, a treasury center CFC that marks to market its assets but not its liabilities may recognize any offsetting foreign currency gains and losses in different taxable years. To avoid this mismatch, taxpayers have taken positions that match a treasury center CFC's foreign currency gains and losses under a variety of theories. No inference is intended in these proposed regulations as to whether these positions are permissible in the years prior to the application of these proposed regulations.

C. Foreign Currency Gain or Loss on Interest-Bearing Liabilities and Related Hedging Transactions

As explained in Part A.3 of this Background section, the business needs exclusion does not apply to foreign currency gain or loss with respect to a transaction or property if any subpart F income arises, or could reasonably be expected to arise, from the transaction or property. § 1.954–2(g)(2)(ii)(B)(*2*). However, § 1.954–2(g)(2)(iii) provides a special rule for foreign currency gain or loss arising from an interest-bearing liability. Under § 1.954–2(g)(2)(iii), such foreign currency gain or loss generally is characterized as subpart F income and non-subpart F income in the same manner that interest expense associated with the liability would be allocated and apportioned between subpart F income and non-subpart F income under §§ 1.861–9T and 1.861–12T. Section 1.954–2(g) does not provide a corresponding rule for a bona fide hedging transaction with respect to an interest-bearing liability. However, § 1.861–9T(b)(2) and (b)(6) provide rules that allocate foreign currency gain or loss on certain hedging transactions in the same manner as interest expense. A foreign currency gain or loss arising from a transaction that hedges an interest-bearing liability and that is not governed by § 1.861–9T is subject to the general rule of § 1.954–2(g)(2)(ii)(B)(*2*) and its "cliff effect." Consequently, although the foreign currency gain or loss on the hedge of an interest-bearing liability economically offsets the foreign currency loss or gain on that liability, the interaction of the regulations under sections 861 and 954 could result in different allocations of foreign currency gains and losses between subpart F income and non-subpart F income.

D. Elections to Treat Foreign Currency Gain or Loss as a Specific Category of Subpart F Income or FBCI or FPHCI

Section 1.954–2 provides two elections with respect to foreign currency gains or losses. Under the first election, the controlling United States shareholders of a CFC may elect to include foreign currency gain or loss that relates to a specific category of subpart F income or, in the case of FBCI, a specific subcategory of FBCI described in § 1.954–1(c)(1)(iii)(A)(*1*) or (*2*), in that category of subpart F income or FBCI, rather than in FPHCI. *See* § 1.954–2(g)(3). Thus, for example, under this election, foreign currency gain or loss on a transaction that hedges currency risk with respect to transactions that result in foreign base company sales income would be included in the foreign base company sales income category for purposes of determining subpart F income. This election associates foreign currency gain or loss that otherwise would be included in the computation of FPHCI with the categories of subpart F income and foreign base company income to which it relates and allows net foreign currency losses with respect to a category to reduce the income in that category. For this treatment to apply, however, the relationship between the foreign currency gain or loss and the category of income must be clearly determinable from the CFC's records. *See* § 1.954–2(g)(3)(i)(A).

Under the second election, the controlling United States shareholders of a CFC may elect to include in the computation of FPHCI all foreign currency gain or loss attributable to any section 988 transaction (except a transaction in which gain or loss is treated as capital gain or loss under section 988(a)(1)(B)) and to certain section 1256 contracts. *See* § 1.954–2(g)(4). When this election is in effect, net foreign currency loss reduces gross income in other categories of FPHCI. Controlling United States shareholders typically make the § 1.954–2(g)(4) election if a CFC has relatively little net foreign currency gain or loss. In those circumstances, the administrative burden of tracing foreign currency gain and loss to specific transactions or property, as is required under the business needs exclusion and the § 1.954–2(g)(3) election, may outweigh the benefit of those provisions. As the CFC's foreign currency gain or loss becomes more significant, the net benefit of the business needs exclusion or the § 1.954–2(g)(3) election may increase and the relative benefit of the § 1.954–2(g)(4) election may decrease.

Explanation of Provisions

A. *Business Needs Exclusion*

1. Transactions and property that give rise to both subpart F income and non-subpart F income

The Treasury Department and the IRS believe that foreign currency gain or loss arising from a transaction or property, or from a bona hedging transaction with respect to such a transaction or property, should be eligible for the business needs exclusion to the extent the transaction or property generates non-subpart F income. Accordingly, proposed § 1.954–2(g)(2)(ii)(C)(*1*) provides that foreign currency gain or loss attributable to a transaction or property that gives rise to both subpart F income and non-subpart F income, and that otherwise satisfies the requirements of the business needs exclusion, is allocated between subpart F income and non-subpart F income in the same proportion as the income from the underlying transaction or property. As a result, the amount of foreign currency gain or loss allocable to non-subpart F income qualifies for the business needs exclusion, and the amount allocable to subpart F income is taken into account in computing FPHCI. Under proposed § 1.954–2(g)(2)(ii)(C)(*1*), the entire foreign currency gain or loss arising from property that does not give rise to income (as defined in § 1.954–2(e)(3)), or from a bona fide hedging transaction with respect to such property, is attributable to subpart F income because any gain upon a disposition of such property would be subpart F income.

2. Hedges of net investment in a QBU

The Treasury Department and the IRS believe that a transaction that manages exchange rate risk with respect to a CFC's net investment in a QBU that is not treated as a separate entity for federal income tax purposes should qualify for the business needs exclusion to the extent the underlying property of the QBU does not give rise to subpart F income. Accordingly, proposed § 1.954–2(g)(2)(ii)(C)(*2*) provides that the qualifying portion of any foreign currency gain or loss that arises from a "financial statement hedging transaction" with respect to a QBU and that is allocable to non-subpart F income is directly related to the business needs of a CFC. A financial statement hedging transaction is defined as a transaction that is entered into by a CFC for the purpose of managing exchange rate risk with respect to part or all of that CFC's net investment in a QBU that is included in the consolidated financial statements of a United States shareholder of the CFC or a corporation that directly or indirectly owns such United States shareholder. The qualifying portion is defined as the amount of foreign currency gain or loss arising from a financial statement hedging transaction that is properly accounted for under U.S. GAAP as a cumulative foreign currency translation adjustment to shareholders' equity. The qualifying portion of any foreign currency gain or loss arising from a financial statement hedging transaction must be allocated between subpart F income and non-subpart F income using the principles of § 1.987–6(b). The amount of the qualifying portion allocated to non-subpart F income qualifies for the business needs exclusion.

The proposed amendment to § 1.446–4(a), discussed in Part B.1 of this Explanation of Provisions section, provides that a bona fide hedging transaction (as defined in § 1.954–2(a)(4)(ii)) is subject to the hedge timing rules of § 1.446–4. Additionally, as noted earlier, proposed § 1.954–2(g)(2)(ii)(C)(*2*) provides that part or all of the qualifying portion of any foreign currency gain or loss arising from a financial statement hedging transaction is eligible for the business needs exclusion. However, financial statement hedging transactions are not included in the definition of bona fide hedging transaction under § 1.954–2(a)(4)(ii), as proposed to be amended pursuant to these proposed regulations. Thus, foreign currency gain or loss arising from a financial statement hedging transaction is not subject to the hedge timing rules of § 1.446–4 and is taken into account in accordance with the taxpayer's method of accounting. Generally, a taxpayer's financial statement hedging transaction is a section 988 transaction with respect to the taxpayer. Accordingly, to the extent that the taxpayer elects to use a mark-to-market method of accounting for section 988 gain or loss under proposed § 1.988–7, and also makes the annual deemed termination election described in § 1.987–8T(d), the taxpayer generally would recognize annually foreign currency gain or loss from both the financial statement hedging transaction and the QBU with respect to which exchange rate risk is managed. The Treasury Department and the IRS request comments regarding whether the hedge timing rules of § 1.446–4 should apply to a financial statement hedging transaction (as defined in proposed § 1.954–2(g)(2)(ii)(C)(*2*)) with respect to section 987 QBUs with respect to which no annual deemed termination election is in effect, and, if so, how the appropriate matching should be achieved.

The Treasury Department and the IRS also request comments regarding whether the business needs exclusion should apply to a transaction that is entered into for the purpose of managing the risk of foreign currency fluctuation with respect to a CFC's net investment in a subsidiary CFC. Comments are requested regarding how the gain or loss on such a transaction could or should be allocated between subpart F and non-subpart F income and whether and how the gain or loss could or should be matched with the foreign currency gain or loss on the "hedged" item.

The Treasury Department and the IRS are aware that a CFC may enter into a transaction that manages exchange rate risk arising from a disregarded loan to a QBU. The Treasury Department and the IRS understand that, for U.S. GAAP purposes, exchange gain or loss with respect to a transaction that manages exchange rate risk with respect to the disregarded loan generally would not be reflected as a cumulative foreign currency translation adjustment. For federal income tax purposes, the loan would be disregarded, and exchange gain or loss on the hedging transaction potentially could be subpart F income. The Treasury Department and the IRS request comments regarding whether, taking into account the amendments in the proposed regulations, additional amendments to the business needs exclusion are appropriate to account for foreign currency gain or loss arising from a transaction that is entered into for the purpose of managing the risk of foreign currency fluctuation with respect to disregarded transactions, including disregarded loans, between a CFC and its QBU. Specifically, comments are requested regarding how the foreign currency gain or loss on such a hedging transaction could or should be allocated between subpart F and non-subpart F income and when such foreign currency gain or should be recognized.

B. *Timing of Foreign Currency Gains and Losses*

1. Extension of § 1.446–4 hedge timing rules to bona fide hedging transactions

The proposed amendment to § 1.446–4(a) extends the hedge timing rules of § 1.446–4 to all bona fide hedging transactions as defined in § 1.954–2(a)(4)(ii). Although this amendment will be particularly useful in connection with foreign currency gains and losses from bona fide hedging transactions of treasury center CFCs, the amendment will eliminate timing mismatches for gains and losses arising from all bona fide hedging transactions and from the hedged property or transaction.

In addition, proposed § 1.954–2(a)(4)(ii) revises the definition of a bona fide hedging transaction to permit the acquisition of a debt instrument by a CFC to be treated as a bona fide hedging transaction with respect to an interest-bearing liability of the CFC, provided that the acquisition of the debt instrument has the effect of managing the CFC's exchange rate risk with respect to the liability within the meaning of § 1.1221–2(c)(4) and (d), determined without regard to § 1.1221–2(d)(5), and otherwise meets the requirements of a bona fide hedging transaction. If a CFC, including a treasury center CFC, identifies a debt instrument that manages exchange rate risk as a hedge of an interest-bearing liability, the foreign currency gain or loss arising from that debt instrument will be taken into account under § 1.446–4 at the same time as the foreign currency gain or loss arising from the hedged interest-bearing liability.

Treating a debt instrument as a hedge of an interest-bearing liability, rather than treating the interest-bearing liability as a hedge of the debt instrument, is consistent with the principles underlying § 1.861–9T(b)(2), which allocates and apportions foreign currency gain or losses on a transaction that hedges an interest-bearing liability in the same manner as interest expense with respect to the liability is allocated and apportioned. See part C of this Explanation of Provisions section for further discussion of the impact of this rule on the allocation of foreign currency gain or loss on a debt instrument between subpart F income and non-subpart F income.

2. Elective mark-to-market method of accounting for foreign currency gain and loss

Proposed § 1.988–7 permits a taxpayer, including a CFC, to elect to use a mark-to-market method of accounting for section 988 gain or loss with respect to section 988 transactions, including becoming an obligor under an interest-bearing liability. This elective mark-to-market method of accounting takes into account only changes in the value of the section 988 transaction attributable to exchange rate fluctuations and does not take into account changes in value due to other factors, such as changes in market interest rates or the creditworthiness of the borrower. The proposed regulations require appropriate adjustments to be made to prevent section 988 gain or loss taken into account under the mark-to-market method of accounting from being taken into account again under section 988 or another provision of the Code.

This election is available to any taxpayer but is expected to be particularly relevant in the case of a treasury center CFC. A treasury center CFC that uses a mark-to-market method for securities under section 475 and that makes the election under proposed § 1.988–7 will be able to match the timing of foreign currency gain or loss with respect to an interest-bearing liability (such as a loan from a related or unrelated party) with economically offsetting foreign currency loss or gain arising from its nonfunctional currency-denominated assets (such as a receivable from a related party). Whether the corresponding foreign currency gains and losses qualify for the business needs exclusion is determined under the rules of § 1.954–2(g)(2), as proposed to be amended pursuant to these proposed regulations. Thus, if the foreign currency gains or losses do not fully offset each other, the difference may increase or decrease the CFC's FPHCI. However, the election under proposed § 1.988–7 does not apply to the following: (1) any securities that are marked to market under any other provision; (2) any securities that, pursuant to an election or an identification made by the taxpayer, are excepted from mark-to-market treatment under any other provision; (3) any transactions of a QBU that is subject to section 987; or (4) any section 988 transactions denominated in, or determined by reference to, a hyperinflationary currency.

The election applies for the year in which the election is made and all subsequent taxable years unless it is revoked by the Commissioner or the taxpayer or, in the case of a CFC, the controlling domestic shareholders of the CFC. Proposed § 1.988–7(d) permits a taxpayer or CFC to revoke the election to use a mark-to-market method of accounting for foreign currency gains or losses on section 988 transactions at any time. A subsequent election cannot be made until the sixth taxable year following the year of revocation and cannot be revoked until the sixth taxable year following the year of such subsequent election.

C. *Hedges of Exchange Rate Risk Arising from an Interest-Bearing Liability*

The Treasury Department and the IRS believe that it is appropriate to require foreign currency gain or loss from transactions that have the effect of managing exchange rate risk arising from an interest-bearing liability to be allocated between subpart F income and non-subpart F income in the same manner as the foreign currency gain or loss on the hedged liability. Accordingly, the proposed amendments to § 1.954–2(g)(2)(iii) require foreign currency gains and losses arising from a transaction or property (including debt instruments) that manages exchange rate risk with respect to an interest-bearing liability to be allocated and apportioned between subpart F income and non-subpart F income in the same manner that foreign currency gain or loss from the interest-bearing liability would be allocated and apportioned. As noted in Part B.1 of this Explanation of Provisions, the proposed amendment to § 1.954–2(a)(4)(ii) revises the definition of a bona fide hedging transaction to permit the acquisition of a debt instrument by a CFC to be treated as a bona fide hedging transaction with respect to an interest-bearing liability of the CFC under certain circumstances. As a result of that proposed amendment and the amendment described in this Part C, if a CFC identifies a debt instrument that manages exchange rate risk as a hedge of an interest-bearing liability, the foreign currency gain or loss arising from that debt instrument will be allocated between subpart F income and non-subpart F income in the same manner as the foreign currency gain or loss arising from the hedged interest-bearing liability. Thus, the proposed amendments to the regulations permit a CFC that timely and properly identifies a debt instrument as a hedge of an interest-bearing liability to alleviate the character mismatch that may occur under the existing regulations, as described in Part C of the Background section of this preamble. The proposed amendments to § 1.954–2(g)(2)(iii) also clarify that the special rules in that paragraph apply to foreign currency gain or loss arising from an interest-bearing liability, or from a bona fide hedging transaction with respect to the liability, in lieu of the general rule of the business needs exclusion in § 1.954–2(g)(2)(ii).

D. *Revocation of Election to Treat Foreign Currency Gain or Loss as a Specific Category of Subpart F Income or as FPHCI*

Proposed § 1.954–2(g)(3)(iii) permits a CFC to revoke its election under § 1.954–2(g)(3) (to characterize foreign currency gain or loss that arises from a specific category of subpart F income as gain or loss in that category) at any time without securing the prior consent of the Commissioner. Similarly, proposed § 1.954–2(g)(4)(iii) permits a CFC to revoke its election under § 1.954–2(g)(4) (to treat all foreign currency gain or loss as FPHCI) at any time without securing the prior consent of the Commissioner. The Treasury Department and the IRS remain concerned about CFCs frequently changing these elections without a substantial business reason but also believe that the ability of a taxpayer to automatically revoke these elections would promote sound tax administration. Therefore, the proposed regulations provide that, if an election has been revoked under proposed § 1.954–2(g)(3)(iii) or proposed § 1.954–2(g)(4)(iii), a subsequent election cannot be made until the sixth taxable year following the year of revocation and any subsequent election cannot be revoked until the sixth year following the year of such subsequent election.

E. *Applicability Dates*

The proposed amendments generally are proposed to apply to taxable years ending on or after the date the proposed regulations are published as final regulations in the **Federal Register**. However, the proposed amendments to §§ 1.446–4(a), 1.954–2(a)(4)(ii)(A), 1.954–2(g)(2)(ii)(C)(*1*), and 1.954–2(g)(2)(iii) are proposed to apply to bona fide hedging transactions entered into on or after the date the proposed regulations are published as final regulations in the **Federal Register**. A taxpayer may rely on any of the proposed amendments, other than the amendments to §§ 1.446–4(a), 1.954–2(a)(4)(ii)(A), 1.954–2(g)(2)(ii)(C)(*1*), and 1.954–2(g)(2)(iii), insofar as each applies to a bona fide hedging transaction, for taxable years ending on or after December 19, 2017, provided the taxpayer consistently applies the proposed amendment for all such taxable years that end before the first taxable year ending on or after the date the proposed regulations are published as final regulations in the **Federal Register**. A taxpayer may rely on any of the proposed amendments to §§ 1.446–4(a), 1.954–2(a)(4)(ii)(A), 1.954–2(g)(2)(ii)(C)(*1*), and 1.954–2(g)(2)(iii) with respect to a bona fide hedging transaction entered into on or after December 19, 2017 and prior to the applicability date, provided the taxpayer consistently applies the proposed amendment to all bona fide hedging transactions entered into on or after December 19, 2017 and prior to the date that these regulations are published as final regulations in the **Federal Register**.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It is hereby certified that the collection of information requirement will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily will affect domestic corporations that have foreign operations, which tend to be larger businesses, and that the average burden is minimal. Accordingly, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under "ADDRESSES." The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

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

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.954–2 also issued under 26 U.S.C. 954(b) and (c). * * *

Section 1.988–7 also issued under 26 U.S.C. 446, 988(d), and 989(c). * * *

Par. 2. Section 1.446–4 is amended by:

1. Revising the first sentence of paragraph (a).
2. Revising the heading of paragraph (g) and adding a sentence at the end of paragraph (g).
3. Removing paragraph (h).

The revisions and addition read as follows:

§ 1.446–4 Hedging transactions.

(a) *In general.* Except as provided in this paragraph (a), a hedging transaction as defined in § 1.1221–2(b) (whether or not the character of gain or loss from the transaction is determined under § 1.1221–2) and a bona fide hedging transaction as defined in § 1.954–2(a)(4)(ii) must be accounted for under the rules of this section. * * *

* * * * *

(g) *Applicability date.* * * * This section applies to a bona fide hedging transaction (as defined in § 1.954–2(a)(4)(ii)) entered into on or after the date that these regulations are published as final regulations in the **Federal Register.**

Par. 3. Section 1.954–0(b) is amended by:

1. Redesignating the entry in the outline for § 1.954–2(g)(2)(ii)(D) as the entry for § 1.954–2(g)(2)(ii)(E).
2. Redesignating the entries in the outline for § 1.954–2(g)(2)(ii)(C), (g)(2)(ii)(C)(*1*), (g)(2)(ii)(C)(*2*), (g)(2)(ii)(C)(*2*)(*i*), (g)(2)(ii)(C)(*2*)(*ii*), and (g)(2)(ii)(C)(*2*)(*iii*) as the entries for § 1.954–2(g)(2)(ii)(D), (g)(2)(ii)(D)(*1*), (g)(2)(ii)(D)(*2*), (g)(2)(ii)(D)(*2*)(*i*), (g)(2)(ii)(D)(*2*)(*ii*), and (g)(2)(ii)(D)(*2*)(*iii*), respectively.
3. Adding new entries in the outline for § 1.954–2(g)(2)(ii)(C), (g)(2)(ii)(C)(*1*), and (g)(2)(ii)(C)(*2*).
4. Revising the entry in the outline for § 1.954–2(g)(2)(iii).

The additions and revision read as follows:

§ 1.954–0 Introduction.

* * * * *

(b) * * *

§ 1.954–2 Foreign personal holding company income.

* * * * *

(g) * * *

(2) * * *

(ii) * * *

(C) Foreign currency gains and losses arising from a transaction or property that gives rise to both non-subpart F income and subpart F income or from a bona fide hedging transaction with respect to such a transaction or property.

(*1*) In general.

(*2*) Financial statement hedging transaction with respect to the net investment in a qualified business unit.

* * * * *

(iii) Special rule for foreign currency gain or loss from an interest-bearing liability and bona fide hedges of an interest-bearing liability.

* * * * *

Par. 4. Section 1.954–2 is amended by:

1. Adding a new sentence after the first sentence in paragraph (a)(4)(ii)(A).
2. Redesignating paragraph (g)(2)(ii)(D) as paragraph (g)(2)(ii)(E).
3. Redesignating paragraph (g)(2)(ii)(C) as paragraph (g)(2)(ii)(D).
4. In newly redesignated paragraph (g)(2)(ii)(D)(*2*)(*i*), removing "paragraph (g)(2)(ii)(C)" and adding "paragraph (g)(2)(ii)(D)" in its place and removing "paragraph (g)(2)(ii)(C)(*1*)" and adding "paragraph (g)(2)(ii)(D)(*1*)" in its place.
5. In newly redesignated paragraph (g)(2)(ii)(D)(*2*)(*ii*), removing "paragraph (g)(2)(ii)(C)(*2*)(*i*)" and adding "paragraph (g)(2)(ii)(D)(*2*)(*i*)" each place it appears.
6. In newly redesignated paragraph (g)(2)(ii)(D)(*2*)(*iii*), removing "paragraph (g)(2)(ii)(C)(*2*)" and adding "paragraph (g)(2)(ii)(D)(*2*)" in its place.
7. Adding paragraph (g)(2)(ii)(C).
8. Revising paragraph (g)(2)(iii).
9. Revising paragraph (g)(3)(iii).
10. Revising paragraph (g)(4)(iii).
11. Adding two new sentences after the third sentence in paragraph (i)(2).

The additions and revisions read as follows:

§ 1.954–2 Foreign personal holding company income.

(a) * * *

(4) * * *

(ii) * * *

(A) * * * Additionally, the acquisition of a debt instrument by a controlled foreign corporation may be treated as a bona fide hedging transaction with respect to an interest-bearing liability of the controlled foreign corporation, provided that the acquisition of the debt instrument has the effect of managing the controlled foreign corporation's exchange rate risk with respect to the liability within the meaning of § 1.1221–2(c)(4) and (d), determined without regard to § 1.1221–2(d)(5), and otherwise meets the requirements of paragraph (a)(4)(ii) of this section. * * *

* * * * *

(g) * * *

(2) * * *

(ii) * * *

(C) *Foreign currency gains and losses arising from a transaction or property that gives rise to both non-subpart F income and subpart F income or from a bona fide hedging transaction with respect to such a transaction or property*—

(*1*) *In general.* If a foreign currency gain or loss would be directly related to the business needs of the controlled foreign corporation pursuant to paragraph (g)(2)(ii)(B)(*1*) or (*2*) of this section except that it arises from a transaction or property that gives rise, or is reasonably expected to give rise, to both non-subpart F income and subpart F income (other than foreign currency gain or loss), or from a bona fide hedging transaction with respect to such a transaction or property, the amount of foreign currency gain or loss that is allocable to non-subpart F income under this paragraph (g)(2)(ii)(C)(*1*) is directly related to the business needs of the controlled foreign corporation. The amount of foreign currency gain or loss arising from a transaction or property described in this paragraph (g)(2)(ii)(C)(*1*), or from a bona fide hedging transaction with respect to such a transaction or property, that is allocable to non-subpart F income equals the product of the total amount of foreign currency gain or loss arising from the transaction or property and the ratio of non-subpart F income (other than foreign currency gain or loss) that the transaction or property gives rise to, or is reasonably expected to give rise to, to the total income that the transaction or property gives rise to, or is reasonably expected to give rise to. However, none of the foreign currency gain or loss arising from property that does not give rise to income (as defined in paragraph (e)(3) of this section), or from a bona fide hedging transaction with respect to such property, is allocable to non-subpart F income.

(*2*) *Financial statement hedging transaction with respect to a qualified business unit*. If foreign currency gain or loss arises from a financial statement hedging transaction (as defined in this paragraph (g)(2)(ii)(C)(*2*)) with respect to a qualified business unit (as defined in § 1.989(a)–1) (QBU) of a controlled foreign corporation that is not treated as an entity separate from the controlled foreign corporation for federal income tax purposes, either because it is a branch or division of the controlled foreign corporation or because it is a business entity that is disregarded as separate from its owner under § 301.7701–3 of this chapter, the amount of the qualifying portion (as determined under this paragraph (g)(2)(ii)(C)(*2*)) of foreign currency gain or loss that is allocable to non-subpart F income under this paragraph (g)(2)(ii)(C)(*2*) is directly related to the business needs of the controlled foreign corporation. Generally, the controlled foreign corporation must allocate the qualifying portion of foreign currency gain or loss arising from the financial statement hedging transaction between subpart F income and non-subpart F income in the same proportion as it would characterize gain or loss determined under section 987 as subpart F income and non-subpart F income under the principles of § 1.987–6(b). A *financial statement hedging transaction* is a transaction that is entered into by a CFC for the purpose of managing exchange rate risk with respect to part or all of that CFC's net investment in a QBU that is included in the consolidated financial statements of a United States shareholder of the CFC (or a corporation that directly or indirectly owns such United States shareholder). The qualifying portion of foreign currency gain or loss is the amount of foreign currency gain or loss arising from a financial statement hedging transaction that is properly accounted for under U.S. generally accepted accounting principles as a cumulative foreign currency translation adjustment to shareholders' equity.

* * * * *

(iii) *Special rule for foreign currency gain or loss from an interest-bearing liability and bona fide hedges of an interest-bearing liability*. Except as provided in paragraph (g)(2)(ii)(D)(*2*) or (g)(5)(iv) of this section, foreign currency gain or loss arising from an interest-bearing liability is characterized as subpart F income and non-subpart F income in the same manner that interest expense associated with the liability would be allocated and apportioned between subpart F income and non-subpart F income under §§ 1.861–9T and 1.861–12T. Likewise, foreign currency gain or loss arising from a bona fide hedging transaction entered into by the controlled foreign corporation that has the effect of managing exchange rate risk with respect to an interest-bearing liability that is not subject to paragraph (g)(2)(ii)(D)(*2*) (certain interest-bearing liabilities treated as dealer property) or (g)(5)(iv) (gain or loss allocated under § 1.861–9) of this section is characterized as subpart F income and non-subpart F income in the same manner that interest expense associated with the interest-bearing liability would be allocated and apportioned between subpart F income and non-subpart F income under §§ 1.861–9T and 1.861–12T. Paragraph (g)(2)(ii) of this section does not apply to any foreign currency gain or loss described in this paragraph (g)(2)(iii).

(3) * * *

(iii) *Revocation of election*. This election is effective for the taxable year of the controlled foreign corporation for which it is made and all subsequent taxable years of such corporation unless revoked by the Commissioner or the controlling United States shareholders (as defined in § 1.964–1(c)(5)) of the controlled foreign corporation. The controlling United States shareholders of a controlled foreign corporation may revoke such corporation's election at any time. If an election has been revoked under this paragraph (g)(3)(iii), a new election under paragraph (g)(3) of this section cannot be made until the sixth taxable year following the year in which the previous election was revoked, and such subsequent election cannot be revoked until the sixth taxable year following the year in which the subsequent election was made. The controlling United States shareholders revoke an election on behalf of a controlled foreign corporation by filing a statement that clearly indicates such election has been revoked with their original or amended income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is revoked.

* * * * *

(4) * * *

(iii) *Revocation of election*. This election is effective for the taxable year of the controlled foreign corporation for which it is made and all subsequent taxable years of such corporation unless revoked by the Commissioner or the controlling United States shareholders (as defined in § 1.964–1(c)(5)) of the controlled foreign corporation. The controlling United States shareholders of a controlled foreign corporation may revoke such corporation's election at any time. If an election has been revoked under this paragraph (g)(4)(iii), a new election under paragraph (g)(4) of this section cannot be made until the sixth taxable year following the year in which the previous election was revoked, and such subsequent election cannot be revoked until the sixth taxable year following the year in which the subsequent election was made. The controlling United States shareholders revoke an election on behalf of a controlled foreign corporation by filing a statement that clearly indicates such election has been revoked with their original or amended income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is revoked.

* * * * *

(i) * * *

(2) *Other paragraphs*. * * * The second sentence of paragraph (a)(4)(ii)(A),

paragraph (g)(2)(ii)(C)(*1*), and the second sentence of paragraph (g)(2)(iii) apply to a bona fide hedging transaction entered into on or after the date the proposed regulations are published as final regulations in the **Federal Register**. Paragraphs (g)(2)(ii)(C) (other paragraph (g)(2)(ii)(C)(*1*), insofar as it applies to a bona fide hedging transaction), (g)(3)(iii), and (g)(4)(iii) of this section apply to taxable years of controlled foreign corporations ending on or after the date that these regulations are published as final regulations in the **Federal Register**.

Par. 5. Section 1.988–7 is added to read as follows:

§ 1.988–7 Election to mark-to-market foreign currency gain or loss on section 988 transactions.

(a) *In general*. Except as provided in paragraph (b) of this section, a taxpayer may elect under this section to apply the foreign currency mark-to-market method of accounting described in this section with respect to all section 988 transactions (including the acquisition and holding of nonfunctional currency described in section 988(c)(1)(C)(ii)). Under the foreign currency mark-to-market method of accounting, the timing of section 988 gain or loss on section 988 transactions is determined under the principles of section 1256. Only section 988 gain or loss is taken into account under the foreign currency mark-to-market method of accounting. Consistent with section 1256(a)(2), appropriate adjustments must be made to prevent the section 988 gain or loss from being taken into account again under section 988 or another provision of the Code or regulations. A section 988 transaction subject to this election is not subject to the "netting rule" of section 988(b) and § 1.988–2(b)(8), under which exchange gain or loss is limited to overall gain or loss realized in a transaction, in taxable years prior to the taxable year in which section 988 gain or loss would be recognized with respect to such section 988 transaction but for this election.

(b) *Exceptions*. The election described in paragraph (a) of this section does not apply to:

(1) Any security, commodity, or section 1256 contract that is marked to market under any other provision, including section 475 or section 1256;

(2) Any security, commodity, or section 1256 contract that, pursuant to an election or an identification made by the taxpayer, is excepted from mark-to-market treatment under another provision, including section 475 or section 1256;

(3) Any transaction of a qualified business unit (as defined in section 1.989(a)–1(b)) that is subject to section 987; or

(4) Any section 988 transaction denominated in, or determined by reference to, a hyperinflationary currency. See § 1.988–2(b)(15), (d)(5), and (e)(7) for rules relating to such transactions.

(c) *Time and manner of election*. A taxpayer makes the election under paragraph (a) of this section by filing a statement that clearly indicates that such election has been made with the taxpayer's timely-filed original federal income tax return for the taxable year for which the election is made. In the case of a controlled foreign corporation, the controlling United States shareholders (as defined in § 1.964–1(c)(5)) make the election under paragraph (a) of this section on behalf of the controlled foreign corporation by filing a statement that clearly indicates that such election has been made with their timely-filed, original federal income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is made.

(d) *Revocation and subsequent election*. A taxpayer may revoke its election under paragraph (a) of this section at any time. If an election has been revoked under this paragraph (d), a new election under paragraph (a) of this section cannot be made until the sixth taxable year following the year in which the previous election was revoked, and such subsequent election cannot be revoked until the sixth taxable year following the year in which the subsequent election was made. A taxpayer revokes the election by filing a statement that clearly indicates that such election has been revoked with its original or amended federal income tax return for the taxable year for which the election is revoked. In the case of a controlled foreign corporation, the controlling United States shareholders revoke the election on behalf of the controlled foreign corporation by filing a statement that clearly indicates that such election has been revoked with their original or amended federal income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is revoked.

(e) *Applicability dates*. This section applies to taxable years of taxpayers (including controlled foreign corporations) ending on or after the date these regulations are published as final regulations in the **Federal Register**.

Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on December 26, 2017, 8:45 a.m., and published in the issue of the Federal Register for December 27, 2017, 82 F.R. 61199)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[1]A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2017–27 through 2017–52 is in Internal Revenue Bulletin 2017–52, dated December 27, 2017.

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