

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2016-10
March 7, 2016

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

INCOME TAX

REG-129067-15, page 421.

These proposed regulations provide a definition of “political subdivision” for purposes of sections 103 and 141 through 150 of the Code and rules stating when to apply that definition. The proposed definition generally provides that a political subdivision must be delegated sufficient sovereign powers, must serve a governmental purpose, and must be controlled by a State or local governmental unit. The proposed definition provides that an issuer must remain a political subdivision for its bonds to remain tax-exempt under section 103. The proposed regulations also streamline certain portions of the existing regulations without changing their meaning.

Rev. Rul. 2016-07, page 391.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for March 2016.

Rev. Proc. 2016-16, page 394.

General Rules and Specifications for Substitute Form 941, Schedule B (Form 941), Schedule D (Form 941), and Schedule R (Form 941) This procedure provides general rules and specifications from the IRS for paper and computer-generated substitutes for Form 941, Schedule B (Form 941), Schedule D (Form 941), and Schedule R (Form 941). This procedure will be reproduced as the next revision of Publication 4436. Rev. Proc. 2015-38 is superseded.

T.D. 9750, page 374.

The final regulations provide guidance to brokers who (1) must report OID income on a tax-exempt debt instrument, (2) must take into account certain debt instrument elections when computing basis, or (3) must prepare a transfer statement for the transfer of a debt instrument or section 1256 option that is a covered security.

T.D. 9751, page 379.

These regulations relate to withholding on foreign persons upon certain dispositions of, and distributions with respect to, U.S. real property interests. The regulations reflect changes made by the Protecting Americans from Tax Hikes Act of 2015. In addition, the regulations update certain mailing addresses listed in regulations under sections 897 and 1445. Specifically, these regulations modify 26 CFR 1.897-2, 26 CFR 1.897-3, 26 CFR 1.1445-1, 26 CFR 1.1445-2, 26 CFR 1.1445-3, 26 CFR 1.1445-4, 26 CFR 1.1445-5, 26 CFR 1.1445-6, and 26 CFR 1.1445-11T.

T.D. 9752, page 385.

These regulations provide guidance regarding the requirements for certain domestic entities to report specified foreign financial assets to the Internal Revenue Service with a timely filed U.S. income tax return. These regulations set forth the conditions under which a domestic corporation, domestic partnership, or domestic trust will be required to undertake such reporting.

EMPLOYEE PLANS

T.D. 9749, page 373.

This regulation addresses the composition of the Joint Board for the Enrollment of Actuaries (the “Joint Board”). The Joint Board establishes standards and qualifications for persons performing actuarial services with respect to pension plans covered by the Employee Retirement Income Security Act of 1974.

(Continued on the next page)

EXEMPT ORGANIZATIONS

REG-118867-10, page 411.

This document contains proposed regulations regarding the prohibition on certain contributions to Type I and Type III supporting organizations and the requirements for Type III supporting organizations. The regulations reflect changes to the law made by the Pension Protection Act of 2006. The regulations will affect Type I and Type III supporting organizations and their supported organizations.

Announcement 2016-11, page 411.

Serves notice to potential donors of a stipulated decision by the United States Tax Court in declaratory judgment proceedings under Section 7428.

EMPLOYMENT TAX

Rev. Proc. 2016-16, page 394.

General Rules and Specifications for Substitute Form 941, Schedule B (Form 941), Schedule D (Form 941), and Schedule R (Form 941) This procedure provides general rules and specifications from the IRS for paper and computer-generated substitutes for Form 941, Schedule B (Form 941), Schedule D (Form 941), and Schedule R (Form 941). This procedure will be reproduced as the next revision of Publication 4436. Rev. Proc. 2015-38 is superseded.

ADMINISTRATIVE

Announcement 2016-06, page 409.

The Office of Professional Responsibility (OPR) announces recent disciplinary sanctions involving attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and appraisers. These individuals are subject to the regulations governing practice before the Internal Revenue Service (IRS), which are set out in Title 31, Code of Federal Regulations, Part 10, and which are published in pamphlet form as Treasury Department Circular No. 230. The regulations prescribe the duties and restrictions relating to such practice and prescribe the disciplinary sanctions for violating the regulations.

The IRS Mission

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

Introduction

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

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

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

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

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

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

T.D. 9749

JOINT BOARD FOR THE ENROLLMENT OF ACTUARIES 20 CFR Part 900

Regulations Governing Organization of the Joint Board for the Enrollment of Actuaries

AGENCY: Joint Board for the Enrollment of Actuaries.

ACTION: Final rule.

SUMMARY: This document contains final regulations relating to the organization of the Joint Board for the Enrollment of Actuaries. The regulations are being amended in order to conform one provision of the regulations to the Bylaws of the Joint Board. These regulations solely address the internal management of the Joint Board and do not affect pension plans, plan participants, actuaries, or the general public.

DATES: *Effective date:* These regulations are effective April 25, 2016.

FOR FURTHER INFORMATION

CONTACT: Patrick McDonough, Executive Director, Joint Board for the Enrollment of Actuaries, at (703) 414-2173 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation

The Joint Board for the Enrollment of Actuaries was established on October 31, 1974 pursuant to section 3041 of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), Public Law 93-406 (ERISA). Section 3041 of ERISA provides that the Secretary of Labor and the Secretary of the Treasury shall, not later than the last day of the first calendar month beginning after the date of enactment of ERISA, establish a Joint Board for the Enrollment of Actuaries (Joint Board).

Regulations under ERISA section 3041 were published in the Federal Register on

April 30, 1975 (40 FR 18776) and are currently located in the Code of Federal Regulations at 20 CFR part 900 (the 1975 Joint Board regulations). These regulations provide that, pursuant to the Bylaws, three members are appointed by the Secretary of the Treasury, two members are appointed by the Secretary of Labor, the Chairman of the Joint Board is to be elected from among the Treasury Department representatives, and the Secretary is to be elected from among the Labor Department representatives.

On April 27, 1981, the Secretaries of Treasury and Labor approved restated Bylaws of the Joint Board (the 1981 Bylaws). Sections 3(b) and 3(c) of the 1981 Bylaws provide that the Chairman and Secretary, respectively, will be elected for a one-year term by the Joint Board from among its members, eliminating the requirement that the Chairman be a Treasury Department representative and the Secretary be a Labor Department representative.

These final regulations amend § 900.3 of the 1975 Joint Board regulations in order to conform the regulations to the 1981 Bylaws.

Special Analyses

These regulations are being published as a final rule because the amendments apply solely to the Joint Board's organization and management. Moreover, the Joint Board finds good cause that these changes do not impose any requirements on any member of the public. These amendments are the most efficient means for the Joint Board to harmonize the regulations and Bylaws involving the Board's internal election procedure.

Accordingly, pursuant to 5 U.S.C. 553(a)(2), 553(b)(3)(A), and 553(b)(3)(B), the Joint Board finds good cause that prior notice and other public procedures with respect to this rule are unnecessary. Because a notice of proposed rulemaking is not required, the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601-612, do not apply.

This rule is not a significant regulatory action pursuant to Executive Order 12866,

as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 20 CFR part 900 is amended as follows:

PART 900—STATEMENT OF ORGANIZATION

Paragraph 1. The authority citation for part 900 continues to read as follows:

Authority: Sec. 3041-2, Pub. L. 93-406, 88 Stat. 829, 1002 (29 U.S.C. 1241-2).

Par. 2. Section 900.3 is revised to read as follows:

§ 900.3 *Composition.*

Pursuant to the Bylaws, the Joint Board consists of three members appointed by the Secretary of the Treasury and two members appointed by the Secretary of Labor. The Board elects a Chairman and a Secretary from among the Department of the Treasury and the Department of Labor members. The Pension Benefit Guaranty Corporation may designate a non-voting representative to sit with, and participate in, the discussions of the Board. All decisions of the Board are made by simple majority vote.

Approved: February 12, 2016.

Carolyn E. Zimmerman,
*Chairman, Joint Board for the
Enrollment of Actuaries.*

(Filed by the Office of the Federal Register on February 22, 2016, 8:45 a.m., and published in the issue of the Federal Register for February 23, 2016, 81 F.R. 03655)

T.D. 9750

**DEPARTMENT OF THE
TREASURY**

**Internal Revenue Service
26 CFR Part 1**

**Reporting of Original Issue
Discount on Tax-Exempt
Obligations; Basis and
Transfer Reporting by
Securities Brokers for Debt
Instruments and Options**

AGENCY: Internal Revenue Service (IRS),
Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to information reporting by brokers for transactions involving debt instruments and options, including the reporting of original issue discount (OID) on tax-exempt obligations, the treatment of certain holder elections for reporting a taxpayer's adjusted basis in a debt instrument, and transfer reporting for section 1256 options and debt instruments. The regulations in this document provide guidance to brokers and payors and to their customers.

DATES: *Effective date:* These regulations are effective on February 18, 2016.

Applicability dates: For the dates of applicability, see §§ 1.6045-1(n)(11)(i)(A), 1.6045-1(n)(11)(i)(B), 1.6045-1(n)(12)(ii), 1.6045A-1(b)(3)(x), 1.6045A-1(b)(4)(iv), and 1.6049-10(c).

FOR FURTHER INFORMATION

CONTACT: Pamela Lew of the Office of the Associate Chief Counsel (Financial Institutions and Products) at (202) 317-7053 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in §§ 1.6045-1(n) and 1.6045A-1(b) of these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control

number 1545-2186. The collection of information is required to comply with the provisions of section 403 of the Energy Improvement and Extension Act of 2008, Division B of Public Law 110-343 (122 Stat. 3765, 3854 (2008)) (the Act). The information required under § 1.6045-1(n) minimizes the need for reconciliation between information reported by a broker to both a customer and the IRS and the amounts reported on the customer's tax return. The information required under § 1.6045A-1 is necessary to allow brokers that effect sales of transferred section 1256 options and debt instruments that are covered securities to determine and report the adjusted basis of these securities in compliance with section 6045(g) of the Internal Revenue Code (Code). The burden for the collection of information contained in § 1.6049-10 of these final regulations will be reflected in the burden for Form 1099-OID, Original Issue Discount (OMB control number 1545-0117), when it is revised to request the additional information in the regulations. This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of tax-exempt interest each year for alternative minimum tax and other purposes. In addition, because this information is used to determine a taxpayer's adjusted basis in a debt instrument for purposes of section 6045(g), this information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of gain or loss upon the sale of a tax-exempt obligation.

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 section 6103.

Background

Section 6045 generally requires a broker to report gross proceeds upon the sale of a security. Section 6045 was amended by section 403 of the Act to require the

reporting of adjusted basis for a covered security and whether any gain or loss upon the sale of the security is long-term or short-term. In addition, the Act added section 6045A of the Code, which requires certain information to be reported in connection with a transfer of a covered security to another broker, and section 6045B of the Code, which requires an issuer of a specified security to file a return relating to certain actions that affect the basis of the security. Section 6049 requires the reporting of interest payments (including accruals of OID treated as payments).

On November 25, 2011, the Treasury Department and the IRS published in the **Federal Register** proposed regulations relating to information reporting by brokers, transferors, and issuers of securities under sections 6045, 6045A, and 6045B for debt instruments, options, and securities futures contracts (REG-102988-11 at 76 FR 72652) (the 2011 proposed basis reporting regulations). On April 18, 2013, the Treasury Department and the IRS published in the **Federal Register** final regulations under sections 6045, 6045A, and 6045B (the 2013 final basis reporting regulations) and temporary regulations relating to information reporting for bond premium and acquisition premium under section 6049 (TD 9616 at 78 FR 23116) (the 2013 temporary interest reporting regulations). A notice of proposed rulemaking cross-referencing the 2013 temporary interest reporting regulations also was published in the **Federal Register** on April 18, 2013 (REG-154563-12 at 78 FR 23183) (the 2013 proposed interest reporting regulations).

On March 13, 2015, the Treasury Department and the IRS published in the **Federal Register** final regulations under sections 6045, 6045A, and 6049 (TD 9713 at 80 FR 13233) (the 2015 final basis reporting regulations, and, together with the 2013 final basis reporting regulations, the final basis reporting regulations). A number of commenters on the 2013 final basis reporting regulations requested changes to the basis reporting rules relating to certain debt elections. In addition, for purposes of section 6045A, several commenters requested that a transferring broker provide additional information on the transfer statement for a debt instru-

ment and that a transferring broker provide a transfer statement for a section 1256 option contract. Several commenters also suggested that the rules for reporting OID associated with a tax-exempt obligation be conformed to the rules regarding basis reporting for those debt instruments. Accordingly, TD 9713 also included temporary regulations relating to information reporting for debt instruments under sections 6045, 6045A, and 6049 (the 2015 temporary reporting regulations). A notice of proposed rulemaking cross-referencing the 2015 temporary reporting regulations was published in the **Federal Register** on March 13, 2015 (REG-143040-14 at 80 FR 13292) (the 2015 proposed reporting regulations). A correction to § 1.6045A-1T(f) was published on June 5, 2015 (TD 9713 at 80 FR 31995), delaying the effective date of § 1.6045A-1T(f) from June 30, 2015, to January 1, 2016.

Written comments were received on the 2015 proposed reporting regulations and are summarized below. No public hearing was requested or held. In general, these final regulations adopt the provisions of the 2015 proposed reporting regulations. These final regulations also remove the corresponding 2015 temporary reporting regulations.

After the publication of the 2015 final basis reporting regulations, the Treasury Department and the IRS received written comments on certain provisions of the final basis reporting regulations. In response to these comments, this document contains final regulations under section 6045 relating to the treatment of certain debt instruments as non-covered securities.

The written comments on the 2015 proposed reporting regulations and the 2015 final basis reporting regulations are available for public inspection at <http://www.regulations.gov> or upon request.

Explanation of Provisions

A. Constant yield election for accruals of market discount.

Under section 1276(b)(2), a customer may elect to accrue market discount on a constant yield method rather than a ratable method. The election may be made on a debt instrument by debt instrument basis and must be made for the earliest taxable

year for which the customer is required to determine accrued market discount. The election may not be revoked once it has been made. In most cases, the use of a constant yield method backloads market discount and is therefore more taxpayer favorable than the use of a ratable method.

In response to comments on the 2013 final basis reporting regulations (which required the broker to assume that the customer had not made a constant yield election), § 1.6045-1T(n)(11)(i)(B) of the 2015 temporary reporting regulations provided that for a debt instrument acquired on or after January 1, 2015, brokers are required to assume that a customer has elected to determine accrued market discount using a constant yield method unless the customer notifies the broker otherwise. A customer that does not want to use a constant yield method to determine accrued market discount must, by the end of the calendar year in which the customer acquired the debt instrument in an account with the broker, notify the broker in writing that the customer wants the broker to use the ratable method to determine accrued market discount.

No comments were received on the substantive rules in § 1.6045-1T(n)(11)(i)(B). Accordingly, the rules in the final regulations in this document are the same as the rules in § 1.6045-1T(n)(11)(i)(B). Several commenters requested permission to apply the default constant yield method to debt instruments acquired on or after January 1, 2014, which was the first date for which a broker was required to report accrued market discount under section 6045, provided that the broker had not reported accrued market discount to a customer for the 2014 calendar year using the ratable method. According to the commenters, the use of a single method to compute market discount accruals for all covered securities with market discount would simplify the calculation of accrued market discount and the reporting of this information to their customers.

The final regulations in this document permit, but do not require, a broker to apply the default constant yield method to a debt instrument acquired on or after January 1, 2014, and before January 1, 2015, provided the broker was not informed that the customer had made a section 1278(b) election (the election to in-

clude market discount in income as it accrues rather than upon a disposition or receipt of a partial principal payment), there were no principal payments on the debt instrument during the 2014 calendar year, and the broker therefore had not reported accrued market discount to the customer for the 2014 calendar year using the ratable method.

B. Transfer statements.

Under § 1.6045A-1T(e) of the 2015 temporary reporting regulations, a transferring broker is required to provide a transfer statement upon the transfer of a section 1256 option to ensure that the receiving broker has all of the information required for purposes of section 6045. The temporary regulations provide that a transfer statement is required for the transfer of a section 1256 option that occurs on or after January 1, 2016. The temporary regulations also list the data specific to section 1256 options that must be provided.

One commenter asserted that including the fair market value information on a transfer statement for a section 1256 option is unnecessary because the receiving broker can look up the information if it is needed and suggested saving space on the transfer statement by eliminating this data item. After considering the suggestion, the Treasury Department and IRS decline to adopt this suggestion. Providing fair market value information on a transfer statement will help ensure that the receiving broker is reporting an amount of realized but unrecognized gain or loss from the prior year that is consistent with the amount reported in the prior year by the transferring broker, which will minimize the possibility of double counting or omission of gain or loss.

No other comments were received on § 1.6045A-1T of the 2015 temporary reporting regulations. The rules in the final regulations in this document are substantively the same as the rules in the 2015 temporary regulations. However, the rules in § 1.6045A-1T(e) are in § 1.6045A-1(b)(4)(iv) of the final regulations in this document and the rules in § 1.6045A-1T(f) are in § 1.6045A-1(b)(3)(x) of the final regulations in this document.

C. Reporting of OID on a tax-exempt obligation.

To coordinate the reporting of OID under section 6049 with the reporting of basis for tax-exempt obligations under section 6045, § 1.6049-10T of the 2015 temporary reporting regulations provides that a payor must report under section 6049 the daily portions of OID on a tax-exempt obligation. The daily portions of OID are determined as if section 1272 and § 1.1272-1 applied to a tax-exempt obligation. A payor must determine whether a tax-exempt obligation was issued with OID and the amount that accrues for each relevant period. In addition, OID on a tax-exempt obligation is determined without regard to the de minimis rule in section 1273(a)(3) and § 1.1273-1(d). Because the temporary regulations require the reporting of OID, payors also must report amortized acquisition premium (which offsets OID) on a tax-exempt obligation. A broker may report either a gross amount for both OID and amortized acquisition premium, or a net amount of OID that reflects the offset of the OID by the amount of amortized acquisition premium allocable to the OID. Section 1.6049-10T of the 2015 temporary reporting regulations applies to a tax-exempt obligation acquired on or after January 1, 2017.

No comments were received on the substantive rules in § 1.6049-10T. Accordingly, the rules in the final regulations in this document are the same as the rules in § 1.6049-10T. However, several commenters requested that, for taxable years beginning after December 31, 2016, a broker be permitted to report on Form 1099-OID the OID and acquisition premium on a tax-exempt obligation that is a covered security acquired before January 1, 2017. According to the commenters, customers might be confused because of the difference between the date that a tax-exempt obligation generally became a covered security (that is, an obligation acquired on or after January 1, 2014), and the date after which a tax-exempt obligation that is a covered security becomes subject to mandatory reporting of OID and acquisition premium (that is, an obligation acquired on or after January 1, 2017). Because a broker is required to track basis for a

tax-exempt obligation that is a covered security for purposes of section 6045, the broker is responsible for calculating OID on a tax-exempt obligation acquired on or after January 1, 2014, even if the broker has no obligation to report the obligation's OID to the customer for purposes of section 6049. To simplify the reporting of OID and acquisition premium and to minimize any customer confusion, the commenters requested that the final regulations permit a broker to report OID and acquisition premium on all tax-exempt bonds that are covered securities.

After considering the requests, for taxable years beginning after December 31, 2016, the final regulations in this document permit, but do not require, a broker to report OID and acquisition premium for a tax-exempt obligation that is a covered security acquired before January 1, 2017.

D. Treatment of certain debt instruments subject to January 1, 2016, reporting.

Under § 1.6045-1(n)(3) of the 2013 final basis reporting regulations, certain debt instruments are subject to basis reporting only if the debt instrument is acquired by a customer on or after January 1, 2016. For example, § 1.6045-1(n)(3) applies to a contingent payment debt instrument, a debt instrument that is not issued by a U.S. issuer, and a debt instrument the terms of which are not reasonably available to a broker within 90 days of acquisition of the debt instrument by the customer.

Several commenters on the 2013 final basis reporting regulations requested guidance for a debt instrument the terms of which are not reasonably available to the broker. The commenters stated that they would not have the information necessary to comply with the information reporting rules for these instruments. Several commenters stated that information for a debt instrument issued by a non-U.S. issuer and for a tax-exempt obligation is particularly difficult to obtain. One commenter noted that under SEC Release 34-67908, issued on September 21, 2012 (77 FR 59427), issuers of municipal securities are required to provide certain data to the Electronic Municipal Market Access system set up by the Municipal Securities Rulemaking Board for new issu-

ances, but there is no requirement to file similar information for issuances already outstanding as of the November 1, 2012, effective date of the release.

The Treasury Department and the IRS agree that a broker may not always be able to obtain information for a debt instrument issued by a non-U.S. issuer or for a tax-exempt obligation issued before January 1, 2014. The final regulations in this document therefore provide that a debt instrument issued by a non-U.S. issuer or a tax-exempt obligation issued before January 1, 2014, is treated as a noncovered security (and, therefore, is not subject to basis reporting under section 6045) if the terms of the debt instrument are not reasonably available to the broker within 90 days of the date the debt instrument was acquired by the customer. The Treasury Department and the IRS believe that the information necessary for section 6045 compliance should be available for other debt instruments.

Applicability Dates

The final regulations under section 6045 in this document (other than § 1.6045-1(n)(12)) apply to a debt instrument acquired on or after January 1, 2015. Section 1.6045-1(n)(12) applies to a debt instrument acquired on or after February 18, 2016. The final regulations under section 6049 in this document apply to a tax-exempt obligation that is a covered security acquired on or after January 1, 2017. The final regulations under section 6045A in this document apply to a transfer of a section 1256 option that occurs on or after January 1, 2016, and to a transfer of a debt instrument that occurs on or after January 1, 2016.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the final regulations in this document will not have a significant economic impact on a substan-

tial number of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. It is anticipated that the requirements in the final regulations in this document, except in the case of the notification by a customer discussed in the next paragraph, will fall only on financial services firms with annual receipts greater than the \$38.5 million threshold and, therefore, on no small entities.

Section 403(a) of the Act requires a broker to report the adjusted basis of a debt instrument that is a covered security. Although a holder of a debt instrument (customer) is permitted to make a number of elections that affect how basis is computed, a broker only is required to take into account specified elections in reporting the adjusted basis of a debt instrument, including the election under section 1276(b)(2) to determine accruals of market discount on a constant yield method. Under the 2013 final basis reporting regulations, a customer was required to notify the broker that the customer had made the section 1276(b)(2) election. However, § 1.6045-1(n)(11)(i)(B) requires a broker to take into account the election under section 1276(b)(2) in reporting a debt instrument's adjusted basis unless the customer timely notifies the broker that the customer has not made the election. The notification must be in writing, which includes a writing in electronic format. In most cases, this election results in a more taxpayer-favorable result than the default ratable method. It is anticipated that this collection of information in the regulations will not fall on a substantial number of small entities, especially because fewer customers will need to notify brokers about the election. Further, the regulations implement the statutory requirements for reporting adjusted basis under section 403 of the Act. Moreover, any economic impact is expected to be minimal because it should take a customer no more than seven minutes to satisfy the information-sharing requirement in these regulations.

Section 403(c) of the Act added section 6045A, which requires applicable persons to provide a transfer statement in connection with the transfer of custody of a covered security. Section 1.6045A-1 effectuates the Act by giving the broker who

receives the transfer statement the information necessary to determine and report adjusted basis and whether any gain or loss with respect to a debt instrument or section 1256 option is long-term or short-term as required by section 6045 when the security is subsequently sold. Consequently, § 1.6045A-1 does not add to the impact on small entities imposed by the statutory provisions. Instead, the regulations limit the information to be reported to only those items necessary to effectuate the statutory scheme.

The information required under § 1.6049-10 will enable the IRS to verify that a taxpayer is reporting the correct amount of tax-exempt interest each year for alternative minimum tax and other purposes. In addition, because this information is used to determine a taxpayer's adjusted basis in a debt instrument for purposes of section 6045(g), this information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of gain or loss upon the sale of a tax-exempt obligation. Any economic impact on small entities is expected to be minimal because a broker already is required to determine the accruals of OID and acquisition premium for purposes of determining and reporting a customer's adjusted basis on Form 1099-B under section 6045. Moreover, any effect on small entities of the rules in the final regulations flows from section 6049 and section 403 of the Act.

Therefore, because the final regulations in this document will not have a significant economic impact on a substantial number of small entities, a regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding the final regulations in this document were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses. No comments were received.

Drafting Information

The principal author of these regulations is Pamela Lew, Office of Associate Chief Counsel (Financial Institutions and Products). 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 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§ 1.6045A-1T and 1.6049-10T and adding an entry for § 1.6049-10 to read in part as follows:

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

Section 1.6049-10 also issued under 26 U.S.C. 6049(a). * * *

Par. 2. Section 1.6045-1 is amended by:

1. Adding a sentence at the end of paragraph (n)(4) introductory text.
2. Revising the last sentence in paragraph (n)(4)(iv).
3. Revising the last sentence in paragraph (n)(5)(i).
4. Revising the second sentence in paragraph (n)(6)(i).
5. Adding a sentence at the end of paragraph (n)(6)(ii).
6. Revising the last sentence in paragraph (n)(7)(iii).
7. Revising “§ 1.6049-9T” to read “§ 1.6049-9” in two places in paragraph (n)(9).
8. Revising paragraph (n)(11).
9. Adding paragraph (n)(12).

The revisions and additions read as follows:

§ 1.6045-1 Returns of information of brokers and barter exchanges.

* * * * *

(n) * * *

(4) * * * See paragraph (n)(11) of this section for the treatment of an election described in paragraph (n)(4)(iii) of this section (election to accrue market discount based on a constant yield) and an election described in paragraph (n)(4)(iv) of this section (election to treat all interest as OID).

(iv) * * * However, see paragraph (n)(11)(i)(A) of this section for a debt instrument acquired on or after January 1, 2014.

* * * * *

(5) * * *

(i) * * * However, see paragraph (n)(11) of this section for the treatment of an election described in paragraph (n)(4)(iii) of this section (election to accrue market discount based on a constant yield) and an election described in paragraph (n)(4)(iv) of this section (election to treat all interest as OID).

* * * * *

(6) * * *

(i) * * * See paragraphs (n)(5) and (n)(11)(i)(B) of this section to determine whether the amount reported should take into account a customer election under section 1276(b)(2). * * *

(ii) * * * See paragraphs (n)(5) and (n)(11)(i)(B) of this section to determine whether the amount reported should take into account a customer election under section 1276(b)(2).

(7) * * *

(iii) * * * However, if a broker took into account a customer election under § 1.1272-3 in 2014, the broker must decrease the customer's basis in the debt instrument by the amount of acquisition premium that is taken into account each year to reduce the amount of the original issue discount that is otherwise includible in the customer's income for that year in accordance with §§ 1.1272-2(b)(5) and 1.1272-3.

* * * * *

(11) *Additional rules for certain holder elections*—(i) *In general*. For purposes of this section, the rules in this paragraph (n)(11) apply notwithstanding any other rule in paragraph (n) of this section.

(A) *Election to treat all interest as OID*. A broker must report the information required under paragraph (d) of this section without taking into account any election described in paragraph (n)(4)(iv) of this section (the election to treat all interest as OID in § 1.1272-3). As a result, for example, a broker must determine the amount of any acquisition premium taken into account each year for purposes of this section in accordance with § 1.1272-2(b)(4). This paragraph (n)(11)(i)(A) applies to a debt instrument acquired on or after January 1, 2015. A broker, however, may rely on this paragraph (n)(11)(i)(A) for a debt instrument acquired on or after January 1, 2014, and before January 1, 2015.

(B) *Election to accrue market discount based on a constant yield*. A broker must report the information required under paragraph (d) of this section by assuming that a customer has made the election described in paragraph (n)(4)(iii) of this section (the election to accrue market discount based on a constant yield). However, if a customer notifies a broker in writing that the customer does not want the broker to take into account this election, the broker must report the information required under paragraph (d) of this section without taking into account this election. The customer must provide this notification to the broker by the end of the calendar year in which the customer acquired the debt instrument in an account with the broker. This paragraph (n)(11)(i)(B) applies to a debt instrument acquired on or after January 1, 2015. A broker, however, may rely on this paragraph (n)(11)(i)(B) to report accrued market discount for a debt instrument that is a covered security acquired on or after January 1, 2014, and before January 1, 2015, if the customer had not informed the broker that the customer had made a section 1278(b) election and there were no principal payments on the debt instrument during this period.

(ii) [Reserved].

(12) *Certain debt instruments treated as noncovered securities*—(i) *In general*. Notwithstanding paragraph (a)(15) of this section, a debt instrument is treated as a noncovered security for purposes of this section if the terms of the debt instrument are not reasonably available to the broker within 90 days of the date the debt instrument was acquired by the customer and the debt instrument is either—

(A) A debt instrument issued by a non-U.S. issuer; or

(B) A tax-exempt obligation issued before January 1, 2014.

(ii) *Effective/applicability date*. Paragraph (n)(12)(i) of this section applies to a debt instrument described in paragraph (n)(12)(i)(A) or (B) of this section that is acquired on or after February 18, 2016. However, a broker may rely on paragraph (n)(12)(i) of this section for a debt instrument described in paragraph (n)(12)(i)(A)

or (B) of this section acquired before February 18, 2016.

* * * * *

Par. 3. Section 1.6045-1T is amended by revising paragraphs (h) through (p) to read as follows:

§ 1.6045-1T *Returns of information of brokers and barter exchanges (temporary)*.

* * * * *

(h) through (p) [Reserved]. For further guidance, see § 1.6045-1(h) through (p).

* * * * *

Par. 4. Section 1.6045A-1 is amended by:

1. Removing “and” at the end of paragraph (b)(3)(viii), removing the period at the end of paragraph (b)(3)(ix) and adding “; and” in its place, and adding paragraph (b)(3)(x).

2. Removing “and” at the end of paragraph (b)(4)(ii), removing the period at the end of paragraph (b)(4)(iii) and adding “; and” in its place, and adding paragraph (b)(4)(iv).

3. Removing paragraphs (e) and (f).
The additions read as follows:

§ 1.6045A-1 *Statements of information required in connection with transfers of securities*.

* * * * *

(b) * * *

(3) * * *

(x) For a transfer that occurs on or after January 1, 2016, the last date on or before the transfer date that the transferor made an adjustment for a particular item (for example, the last date on or before the transfer date that bond premium was amortized). A broker, however, may rely on this paragraph (b)(3)(x) for a transfer of a covered security that occurs on or after June 30, 2015, and before January 1, 2016.

(4) * * *

(iv) For a transfer of an option described in § 1.6045-1(m)(3) (section 1256 option) that occurs on or after January 1, 2016, the original basis of the option and the fair market value of the option as of the end of the prior calendar year.

* * * * *

§ 1.6045A-1T [Removed]

Par. 5. Section 1.6045A-1T is removed.

Par. 6. Section 1.6049-10 is added to read as follows:

§ 1.6049-10 Reporting of original issue discount on a tax-exempt obligation.

(a) *In general.* For purposes of section 6049, a payor (as defined in § 1.6049-4(a)(2)) of original issue discount (OID) on a tax-exempt obligation (as defined in section 1288(b)(2)) is required to report the daily portions of OID on the obligation as if the daily portions of OID that accrued during a calendar year were paid to the holder (or holders) of the obligation in the calendar year. The amount of the daily portions of OID that accrues during a calendar year is determined as if section 1272 and § 1.1272-1 applied to a tax-exempt obligation. Notwithstanding any other rule in section 6049 and the regulations thereunder, a payor must determine whether a tax-exempt obligation was issued with OID and the amount of OID that accrues for each relevant period. As prescribed by section 1288(b)(1), OID on a tax-exempt obligation is determined without regard to the de minimis rules in section 1273(a)(3) and § 1.1273-1(d).

(b) *Acquisition premium.* A payor is required to report acquisition premium amortization on a tax-exempt obligation in accordance with the rules in § 1.6049-9(c) as if section 1272 applied to a tax-exempt obligation. See paragraph (a) of this section to determine the amount of OID allocable to an accrual period.

(c) *Effective/applicability date.* This section applies to a tax-exempt obligation that is a covered security (within the meaning of § 1.6045-1(a)(15) and (n)(12)) acquired on or after January 1, 2017. For a taxable year beginning after December 31, 2016, a broker, however, may rely on this section to report OID and acquisition premium for a tax-exempt obligation that is a covered security acquired before January 1, 2017.

§ 1.6049-10T [Removed]

Par. 7. Section 1.6049-10T is removed.

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

Approved: January 13, 2016.

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

(Filed by the Office of the Federal Register on February 17, 2016, 8:45 a.m., and published in the issue of the Federal Register for February 18, 2016, 81 F.R. 8149)

T.D. 9751

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

**PATH Act Changes to
Section 1445**

AGENCY: Internal Revenue Service (IRS),
Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the taxation of, and withholding on, foreign persons upon certain dispositions of, and distributions with respect to, United States real property interests (USRPIs). The regulations reflect changes made by the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act). In addition, the regulations update certain mailing addresses listed in regulations under sections 897 and 1445. These regulations affect certain holders of USRPIs and withholding agents that are required to withhold tax on certain dispositions of, and distributions with respect to, USRPIs. This document also requests comments on certain other aspects of the PATH Act that apply to dispositions of, and distributions with respect to, USRPIs.

DATES: *Effective date:* These regulations are effective on February 19, 2016.

Applicability date: For dates of applicability, see §§ 1.1445-1(h), 1.1445-2(e), and 1.1445-5(h).

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-101329-16), 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-101329-16), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224, or sent electronically via the Federal eRule-making Portal at <http://www.regulations.gov> (IRS REG-101329-16).

FOR FURTHER INFORMATION
CONTACT: Milton M. Cahn or David A. Levine, (202) 317-6937; concerning submissions of comments, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations were previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control numbers 1545-0123, 1545-0902, and 1545-1797 in conjunction with Treasury decisions 7999 (49 FR 50689, Dec. 31, 1984), 8113 (51 FR 46620, Dec. 24, 1986), and 9082 (68 FR 46081, Aug. 5, 2003), respectively. There are no proposals for substantive changes to these collections of information.

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 might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 897(a)(1) provides, in general, that gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest (USRPI) shall be taken into account under section 871(b)(1) or 882(a)(1), as applicable, as if the nonres-

ident alien individual or foreign corporation were engaged in a trade or business within the United States during the taxable year and such gain or loss were effectively connected with that trade or business.

Section 897(c)(1)(A) defines a USRPI to include any interest (other than solely as a creditor) in any domestic corporation unless the taxpayer establishes that such corporation was at no time a United States real property holding corporation (USRPHC) during the applicable testing period (generally, the five-year period ending on the date of the disposition of the USRPHC). Under section 897(c)(2), a USRPHC means any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the total fair market value of its USRPIs, its interests in real property located outside the United States, and any other assets that are used or held for use in a trade or business. However, section 897(c)(1)(B) generally provides that an interest in a corporation is not a USRPI if the corporation does not hold USRPIs as of the date its stock is sold and the corporation disposed of all of the USRPIs that it held during the applicable testing period in transactions in which the full amount of gain, if any, was recognized (the cleansing exception).

Section 1445(a) generally imposes a withholding tax obligation on the transferee when a foreign person disposes of a USRPI. Section 1445(f)(3) provides that a foreign person is any person other than a United States person. Section 1445(e)(3) generally imposes a withholding obligation on a domestic corporation that is a USRPHC on distributions to foreign persons to which section 302 or sections 331 through 346 apply. Section 1445(e)(3) also provides that similar rules are applicable to distributions to foreign persons under section 301 that are not made out of the earnings and profits of the domestic corporation. Section 1445(e)(4) generally requires a domestic or foreign partnership, the trustee of a domestic or foreign trust, or the executor of a domestic or foreign estate to withhold on the distribution of any USRPI to a partner or beneficiary who is a foreign person. Under section 1445(e)(5), the transferee of a partnership interest or of a beneficial interest in a trust or estate is required to deduct and withhold tax

to the extent provided in regulations. Any amounts withheld under section 1445 are credited against the foreign transferor's U.S. tax liability. § 1.1445-1(f)(1).

Before the enactment of the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113 (the PATH Act), the withholding rate under sections 1445(a), 1445(e)(3), 1445(e)(4), and 1445(e)(5) was 10 percent of either the amount realized or the fair market value of the interest, as applicable. Section 324(a) of the PATH Act increased the withholding rate under these sections from 10 percent to 15 percent. This new rate applies to dispositions after February 16, 2016. Section 324(b) of the PATH Act, however, retained the 10-percent withholding rate in the case of a disposition of property that is acquired by the transferee for his or her use as a residence with respect to which the amount realized is greater than \$300,000 but does not exceed \$1 million.

Section 325 of the PATH Act provides that the cleansing exception will not apply to dispositions on or after December 18, 2015, if the corporation or its predecessor was a real estate investment trust or a regulated investment company at any time during the shorter of the period that the shareholder held the interest or the five-year period ending on the date of the disposition of the shareholder's interest in the corporation.

Section 323(a) of the PATH Act added section 897(l), which provides that section 897 does not apply (i) to USRPIs held directly (or indirectly through one or more partnerships) by, or (ii) to distributions received from a real estate investment trust by, a qualified foreign pension fund or an entity wholly owned by a qualified foreign pension fund. Section 897(l)(2) defines a qualified foreign pension fund for purposes of section 897(l), and section 897(l)(3) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 897(l). In addition, section 323(b) of the PATH Act amended the definition of foreign person in section 1445(f)(3) to provide that entities described in section 897(l) are not treated as foreign persons for purposes of section 1445, except as otherwise provided by the Secretary. The amendments in section 323 of the PATH Act are applicable to dispo-

sitions and distributions after December 18, 2015.

Explanation of Provisions

These regulations update § 1.897-2 and §§ 1.1445-1 through 1.1445-5, and append an informational footnote to § 1.1445-11T(d)(2)(iii), to reflect changes made by the PATH Act.

Additionally, for certain filings that are described in regulations under sections 897 and 1445, these regulations provide that the mailing address is the address specified in the Instructions for Form 8288 under the heading "Where To File."

Applicability Dates

Consistent with the PATH Act, the revisions to § 1.1445-2 to incorporate the exemption under section 1445(f)(3) for entities described in section 897(l) apply to dispositions and distributions after December 18, 2015, and the revisions to § 1.897-2 regarding the cleansing exception apply to dispositions on or after December 18, 2015. The new withholding rates described in these regulations apply to dispositions of, and distributions with respect to, USRPIs that occur after February 16, 2016.

Beginning after February 19, 2016, taxpayers are required to use the revised mailing address provided in these regulations. However, the IRS will not assert penalties against taxpayers that use the mailing address previously specified in the regulations on or before June 20, 2016. Any prior timely filings made pursuant to the regulations under sections 897 and 1445 that were mailed to the address specified in the Instructions for Form 8288 under the heading "Where To File," instead of the address previously specified in the regulations, have been accepted by the IRS.

Request for Comments

The Treasury Department and the IRS request comments regarding what regulations, if any, should be issued pursuant to section 897(l)(3). All comments that are submitted as prescribed in this preamble under the "Addresses" heading will be available at www.regulations.gov or upon request.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. Because no notice of proposed rulemaking is required, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

The Treasury Department and the IRS have determined that section 553(b) of the Administrative Procedure Act (APA) (5 U.S.C. chapter 5) does not apply to these regulations, including because good cause exists under section 553(b)(B) of the APA. Section 553(b)(B) of the APA provides that an agency is not required to publish a notice of proposed rulemaking in the Federal Register when the agency, for good cause, finds that notice and public comment thereon are impracticable, unnecessary, or contrary to the public interest. These regulations are necessary to ensure that existing regulations for trans-

feres and other parties properly reflect the changes implemented by the PATH Act. Because these regulations merely conform the regulations to certain changes made by the PATH Act, and update certain mailing addresses, prior notice and public comment is unnecessary. Accordingly, good cause exists for dispensing with notice and public comment pursuant to section 553(b) of the APA. For the same reasons that section 553(b) of the APA does not apply, including because good cause exists under section 553(d)(3) of the APA, the requirements in section 553(d) of the APA for a delayed effective date are inapplicable.

Drafting Information

The principal authors of these regulations are Milton M. Cahn and David A. Levine of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:
Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.897-2 is amended as follows:

1. By removing “, and” at the end of paragraph (f)(2)(i) and adding a semicolon in its place.
2. By removing the period at the end of paragraph (f)(2)(ii) and adding “; and” in its place.
3. By adding paragraph (f)(2)(iii) before the existing undesignated paragraph.
4. In each of the paragraphs listed in the first column by removing the language in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(h)(2)(v), third sentence	the Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114-0586	the address specified in the Instructions for Form 8288 under the heading “Where To File”
(h)(4)(ii), first sentence	the Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114-0586	the address specified in the Instructions for Form 8288 under the heading “Where To File”

The addition reads as follows:

§ 1.897-2 *United States real property holding corporations.*

- * * * * *
- (f) * * *
- (2) * * *
- (i) * * *

- (ii) * * *
- (iii) If the disposition occurs on or after December 18, 2015, neither the corporation nor any predecessor of the corporation was a regulated investment company or a real estate investment trust at any time during the shorter of the periods described in section 897(c)(1)(A)(ii).

* * * * *

§ 1.897-3 [Amended]

Par. 3. Section 1.897-3 is amended in each of the paragraphs listed in the first column by removing the language in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(c) introductory text, first sentence	with the Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114-0586	at the address specified in the Instructions for Form 8288 under the heading “Where To File”
(d)(1), fourth sentence	the Philadelphia Service Center	the address specified in the Instructions for Form 8288 under the heading “Where To File”
(f)(1), second sentence	addressed to the Director, Philadelphia Service Center, P.O. Box 21086, Drop Point 8731, FIRPTA Unit, Philadelphia, PA 19114-0586	delivered to the address specified in the Instructions for Form 8288 under the heading “Where To File”
(f)(1), fifth sentence	the Director, Philadelphia Service Center	the address specified in the Instructions for Form 8288 under the heading “Where To File”

Par. 4. Section 1.1445-1 is amended as follows:

1. By revising the first sentence and removing the last sentence of paragraph (b)(1).

2. By redesignating paragraphs (b)(2) through (4) as paragraphs (b)(3) through (5) respectively.

3. By adding a new paragraph (b)(2).

4. By revising paragraph (g)(10).

5. By revising the heading and adding two sentences after the first sentence in paragraph (h).

6. In each of the paragraphs listed in the first column by removing the language

in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(a), second sentence	10 percent	15 percent (10 percent in the case of dispositions described in paragraph (b)(2) of this section)
newly designated (b)(4)(iii), first sentence	10 percent	15 percent
newly designated (b)(4)(iii), second sentence	§ 1.1445-1(b)(3)(iii)	paragraph (b)(4)(iii)
(c)(2)(i)(A), first sentence	10 percent	15 percent (10 percent in the case of dispositions described in paragraph (b)(2) of this section)
(c)(2)(i)(B), third sentence	10 percent	15 percent (10 percent in the case of dispositions described in paragraph (b)(2) of this section)

The additions and revisions read as follows:

§ 1.1445-1 Withholding on dispositions of U.S. real property interests by foreign persons: In general.

* * * * *

(b) *Duty to withhold*—(1) *In general.* Except as provided in paragraph (b)(2) and §§ 1.1445-2 and 1.1445-3, transferees of U.S. real property interests are required to deduct and withhold a tax equal to 15 percent of the amount realized by the transferor if the transferor is a foreign person.* * *

(2) *Reduced rate for certain residences.* Transferees of U.S. real property interests are required to deduct and withhold a tax equal to 10 percent of the amount realized by the transferor if the transferor is a foreign person and the following requirements are satisfied:

(i) the property is acquired by the transferee for use by the transferee as a residence;

(ii) the amount realized for the property does not exceed \$1,000,000; and

(iii) section 1445(b)(5) does not apply to the disposition. See § 1.1445-2(d)(1).

* * * * *

(g) * * *

(10) *Address for correspondence.* Any written communication to the Internal Revenue Service described in this section is to be mailed to the address specified in the Instructions for Form 8288 under the heading “Where To File.”

(h) *Applicability dates.* * * * The withholding rates set forth in paragraphs (a), (b)(1), (b)(2), (b)(4)(iii), (c)(2)(i)(A), and (c)(2)(i)(B) of this section apply to dispositions after February 16, 2016. For dispositions on or before February 16, 2016, see paragraphs (a), (b)(1), (b)(3)(iii), (c)(2)(i)(A), and (c)(2)(i)(B) of this section as contained in 26 CFR part 1 revised as of April 1, 2015.

Par. 5. Section 1.1445-2 is amended as follows:

1. By revising the first sentence in the undesignated paragraph following paragraph (b)(2)(i)(C).

2. In paragraph (b)(4)(iv), by adding a sentence after the last sentence.

3. In paragraph (e), by revising the heading and adding two sentences after the first sentence.

4. In each of the paragraphs listed in the first column by removing the language in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(b)(4)(iv), second sentence	10 percent	15 percent
(b)(4)(iv), third sentence	10 percent	15 percent
(b)(4)(iv), fourth sentence	10 percent	15 percent
(c)(3)(iii), second sentence	10 percent	15 percent
(c)(3)(iii), third sentence	10 percent	15 percent
(c)(3)(iii), fourth sentence	10 percent	15 percent
(d)(2)(i)(B), first sentence	provides a copy of the transferor’s notice to the Director, Philadelphia Service Center	mails a copy of the transferor’s notice to the Internal Revenue Service
(d)(3)(i)(A) introductory text, first sentence	10 percent	15 percent (10 percent in the case of dispositions described in § 1.1445-1(b)(2))
(d)(3)(i)(B) introductory text, first sentence	10 percent	15 percent (10 percent in the case of dispositions described in § 1.1445-1(b)(2))

The additions and revision read as follows:

§ 1.1445-2 *Situations in which withholding is not required under section 1445(a).*

- * * * * *
- (b) * * *
- (2) * * *
- (i) * * *
- (C) * * *

In general, a foreign person is a non-resident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate, but not a qualified foreign

pension fund (as defined in section 897(l)) or an entity all of the interests of which are held by a qualified foreign pension fund. * * *

(4) * * *

(iv) * * * For dispositions described in § 1.1445-1(b)(2), this paragraph shall be applied by replacing “15 percent” with “10 percent” each time it appears.

* * * * *

(e) *Applicability dates.* * * * The exclusion of entities described in section 897(l) from the definition of foreign person in paragraph (b)(2)(i) of this section applies to dispositions and distributions after December 18, 2015, and the with-

holding rates set forth in paragraphs (b)(4)(iv), (c)(3)(iii), and (d)(3)(i) of this section apply to dispositions after February 16, 2016. For dispositions on or before February 16, 2016, see paragraphs (b)(4)(iv), (c)(3)(iii), and (d)(3)(i) of this section as contained in 26 CFR part 1 revised as of April 1, 2015.

§ 1.1445-3 [Amended]

Par. 6. Section 1.1445-3 is amended in each of the paragraphs listed in the first column by removing the language in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(b)(1), first sentence	to the Director, Philadelphia Service Center, at	to
(f)(1), first sentence	to the Director, Philadelphia Service Center, at	to
(f)(2)(iii), heading	by the Director, Philadelphia Service Center,	on behalf of the Service
(f)(2)(iii), first sentence	by the Director, Philadelphia Service Center or his delegate	on behalf of the Service
(g) introductory text, third sentence	addressed to the Director, Philadelphia Service Center, at	delivered to

§ 1.1445-4 [Amended]

Par. 7. Section 1.1445-4 is amended in each of the paragraphs listed in the first

column by removing the language in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(c)(1), tenth sentence	from a foreign person must withhold a tax equal to 10 percent	from a foreign person after February 16, 2016, must withhold a tax equal to 15 percent (10 percent in the case of dispositions described in § 1.1445-1(b)(2))
(c)(1), thirteenth sentence	10 percent tax	15 percent tax (10 percent tax in the case of dispositions described in § 1.1445-1(b)(2))
(c)(2), second sentence	to the Director, Philadelphia Service Center, at	to

Par. 8. Section 1.1445-5 is amended as follows:

1. In each of the paragraphs listed in the first column, by removing the language in the “Remove” column and add-

ing in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(b)(2)(ii) introductory text, first sentence	to the Director, Philadelphia Service Center, at	to
(c)(3)(iv) introductory text, second sentence	10 percent	15 percent
(c)(3)(v), first sentence	with the Director, Philadelphia Service Center, at	at
(c)(3)(v), fifth sentence	with the Director, Philadelphia Service Center, at	at
(e)(1) introductory text, first sentence	10 percent	15 percent

2. In paragraph (h), by revising the heading and adding two sentences after the first sentence.

The revision and additions read as follows:
 § 1.1445-5 *Special rules concerning distributions and other transactions by corporations, partnerships, trusts, and estates.*

* * * * *

(h) *Applicability dates.* * * * The withholding rates set forth in paragraphs (c)(3)(iv) and (e)(1) of this section apply to distributions after February 16, 2016. For distributions on or before February 16, 2016, see paragraphs (c)(3)(iv) and (e)(1) of this section as contained in 26 CFR part 1 revised as of April 1, 2015.

§ 1.1445-6 [Amended]

Par. 9. Section 1.1445-6 is amended in each of the paragraphs listed in the first column by removing the language in the “Remove” column and adding in its place the language in the “Add” column.

<i>Paragraph</i>	<i>Remove</i>	<i>Add</i>
(f)(1), first sentence	to the Director, Philadelphia Service Center, at	to
(f)(2)(iii), heading	by the Director, Philadelphia Service Center	on behalf of the Service
(f)(2)(iii), first sentence	by the Director, Philadelphia Service Center, or his delegate	on behalf of the Service
(g) introductory text, second sentence	addressed to the Director, Philadelphia Service Center, at	delivered to

§ 1.1445-11T [Amended]

Par. 10. Section 1.1445-11T is amended in paragraph (d)(2)(iii) by adding footnote “1” after the last sentence to read as follows:

§ 1.1445-11T *Special rules requiring withholding under § 1.1445-5 (temporary).*

* * * * *

(d) * * *

(2) * * *

(iii) * * *

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

John Dalrymple,
 Deputy Commissioner for
 Services and Enforcement.

(Filed by the Office of the Federal Register on February 17, 2016, 4:15 p.m., and published in the issue of the Federal Register for February 19, 2016, 81 F.R. 03421)

Approved: February 12, 2016.

¹ Section 324(a) of the Protecting Americans from Tax Hikes Act of 2015 (Public Law 114-113) increased the withholding rate under section 1445(e)(5) to 15 percent, applicable to dispositions after February 16, 2016.

T.D. 9752

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Reporting of Specified Foreign Financial Assets

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the requirements for certain domestic entities to report specified foreign financial assets to the Internal Revenue Service. These regulations set forth the conditions under which a domestic entity will be considered a specified domestic entity required to undertake such reporting. These regulations affect certain domestic corporations, partnerships, and trusts.

DATES: *Effective date:* These regulations are effective on February 23, 2016.

Applicability date: For dates of applicability, see §§ 1.6038D-2(g) and 1.6038D-6(e).

FOR FURTHER INFORMATION

CONTACT: Joseph S. Henderson, (202) 317-6942 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 6038D was enacted by section 511 of the Hiring Incentives to Restore Employment (HIRE) Act, Public Law 111-147 (124 Stat. 71). Section 6038D(a) requires certain individuals to report information about specified foreign financial assets. Section 6038D(f) provides that, to the extent provided by the Secretary in regulations or other guidance, section 6038D shall apply to any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if the entity were an individual.

On December 19, 2011, the Department of the Treasury (Treasury Depart-

ment) and the Internal Revenue Service (IRS) published temporary regulations (the “2011 temporary regulations”) (TD 9567) and a notice of proposed rulemaking by cross-reference to temporary regulations (REG-130302-10) in the **Federal Register** (76 FR 78553 and 76 FR 78594, respectively) addressing the reporting requirements under section 6038D. The notice of proposed rulemaking also included proposed § 1.6038D-6, which set forth the conditions under which a domestic entity will be considered a specified domestic entity and, therefore, required to report specified foreign financial assets in which it holds an interest. Corrections to the 2011 temporary regulations were published on February 21, 2012, in the **Federal Register** (77 FR 9845). Corrections to proposed § 1.6038D-6 were published on February 21, 2012, and February 22, 2012, in the **Federal Register** (77 FR 9877 and 77 FR 10422, respectively). The 2011 temporary regulations were issued as final regulations (TD 9706; 79 FR 73817) on December 12, 2014 (the “2014 final regulations”). The Treasury Department and the IRS did not adopt proposed § 1.6038D-6 (REG-144339-14) as a final regulation at that time.

The Treasury Department and the IRS received written comments on proposed § 1.6038D-6. All comments are available at www.regulations.gov or upon request. Because no requests to speak were received, no public hearing was held. After consideration of the comments received, the Treasury Department and the IRS adopt proposed § 1.6038D-6 as a final regulation with the modifications described herein.

Summary of Comments and Explanation of Revisions

I. Organizational Changes Regarding the Reporting Threshold

Proposed §§ 1.6038D-6(b)(1)(i) and 1.6038D-6(c)(1) provide that, in order to be treated as a specified domestic entity, an entity must have an interest in specified foreign financial assets (excluding assets excepted under § 1.6038D-7T) that exceeds the reporting threshold in § 1.6038D-2T(a)(1). Under the proposed regulations, a domestic entity applies the reporting threshold in § 1.6038D-2T(a)(1)

to determine whether it is a specified domestic entity. In making this determination, the proposed regulations require a corporation or partnership to take into account the aggregation rules in proposed § 1.6038D-6(b)(4)(i). Proposed §§ 1.6038D-6(b)(1)(i) and 1.6038D-6(c)(1), however, suggested that a specified domestic entity is required to again apply § 1.6038D-2T(a)(1) to determine whether it has a reporting requirement.

The Treasury Department and the IRS did not intend for domestic entities to apply the reporting threshold described in § 1.6038D-2(a)(1) twice in order to determine their section 6038D reporting responsibilities. Therefore, these final regulations eliminate the requirement to apply § 1.6038D-2(a)(1) as part of determining whether an entity is a specified domestic entity. Instead, a domestic entity that meets the definition of a specified domestic entity, which under these final regulations is determined without regard to whether the reporting threshold in § 1.6038D-2(a)(1) is met, applies the reporting threshold under § 1.6038D-2(a)(1) once, as part of determining whether it has a filing obligation. The aggregation rule for corporations and partnerships and the rule excluding assets excepted under § 1.6038D-7 from the reporting threshold have been moved to § 1.6038D-2(a)(6). These changes are organizational and no change is intended to the substantive reporting requirements for a specified domestic entity.

II. Elimination of Principal Purpose Test

Proposed § 1.6038D-6(b)(1)(iii) provides that a corporation or partnership is treated as formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if either: (1) at least 50 percent of the corporation or partnership’s gross income or assets is passive; or (2) at least 10 percent of the corporation or partnership’s gross income or assets is passive and the corporation or partnership is formed or availed of by a specified individual with a principal purpose of avoiding section 6038D (the principal purpose test). Under proposed § 1.6038D-6(b)(1)(iii), all facts and circumstances are taken into account to determine whether a specified individual has

a principal purpose of avoiding section 6038D.

The Treasury Department and the IRS believe that a 50-percent passive assets or income threshold appropriately captures situations in which specified individuals may use a domestic corporation or partnership to circumvent the reporting requirements of section 6038D. Furthermore, the Treasury Department and the IRS have concluded that taxpayers should be able to determine their reporting requirements under section 6038D based on objective requirements rather than a subjective principal purpose test. Therefore, these final regulations eliminate the principal purpose test for determining whether a corporation or partnership is a specified domestic entity. However, the Treasury Department and the IRS will continue to monitor whether domestic corporations and partnerships not required to report under these final regulations are being used inappropriately by specified individuals to avoid reporting under section 6038D. If needed, the Treasury Department and the IRS may expand the definition of a specified domestic entity in future guidance.

III. Definition of Passive Income

Proposed § 1.6038D-6(b)(2) defines “passive income” by listing specific items of income that are treated as passive. Following the issuance of proposed § 1.6038D-6(b)(2), on February 15, 2012, comprehensive regulations (77 FR 9022 (REG-121647-10)) were proposed under sections 1471 through 1474, which were also enacted as part of the HIRE Act that enacted section 6038D. A definition of passive income was included in the proposed regulations under section 1472 for purposes of identifying certain active non-financial foreign entities (NFFE), which are excepted from withholding under section 1472(a) and therefore do not have to report their substantial U.S. owners in order to avoid withholding. The definition of passive income in proposed § 1.1472-1(c)(1)(v) contained a list of items that was similar, although not identical, to the list contained in proposed § 1.6038D-6(b)(2). On January 28, 2013, the proposed regulations under sections 1471 through 1474 were finalized (78 FR 5874,

TD 9610). In the final regulations, the Treasury Department and the IRS clarified the scope of the definition of passive income, made modifications in response to comments received, and moved the provision to § 1.1472-1(c)(1)(iv)(A). In addition, exceptions for look-through payments and dealers were added in § 1.1472-1(c)(1)(iv)(B).

The definitions of passive income under sections 1472 and 6038D serve a similar function, which is to identify entities that have a high risk of being used for tax evasion and to reduce compliance burdens for active entities. Therefore, these final regulations in § 1.6038D-6(b)(2) adopt several of the modifications to the term “passive income” that were included in § 1.1472-1(c)(1)(iv)(A). Specifically, these modifications: (1) Clarify that “dividends” includes substitute dividends and expand “interest” to cover income equivalent to interest, including substitute interest, (2) add a new exception for certain active business gains or losses from the sale of commodities, and (3) define notional principal contracts by adding a reference to § 1.446-3(c)(1). In addition, these final regulations add the exception for dealers that is described in § 1.1472-1(c)(1)(iv)(B)(2).

In addition, the proposed regulations under both sections 1472 and 6038D excluded from the definition of passive income rents or royalties derived in the active conduct of a trade or business conducted by employees of the relevant entity. A comment submitted in response to proposed § 1.6038D-6(b)(2)(iii) expressed concern that the exception applies only to rents and royalties derived in an active trade or business conducted exclusively by a corporation’s or partnership’s employees, and noted that it is difficult to find a trade or business that is conducted solely by a business’s employees. These final regulations provide, consistent with § 1.1472-1(c)(1)(iv)(A)(4), that rents and royalties derived in the active conduct of a trade or business conducted “at least in part” by employees of the corporation or partnership will not be considered passive income.

The exception for certain look-through income from related persons in § 1.1472-1(c)(1)(iv)(B)(I) is not adopted in these final regulations because § 1.6038D-6(b)(3)(ii) al-

ready eliminates passive income or assets arising from related party transactions for purposes of applying the passive income and asset thresholds to a corporation or partnership with related entities.

Finally, the proposed regulations did not specify how to determine whether 50 percent of a corporation’s or partnership’s assets are passive assets. The Treasury Department and the IRS believe that the weighted average test for active NFFEs in the regulations under section 1472 provides an administrable way to determine the passive asset percentage. Therefore, these final regulations provide that the passive asset percentage is determined based on a weighted average approach similar to the rule in § 1.1472-1(c)(1)(iv). Under this test, corporations or partnerships may use either fair market value or book value (as reflected on the entity’s balance sheet and as determined under either a U.S. or an international financial accounting standard) to determine the value of their assets. Corporations or partnerships may be required to substantiate their determination of the passive asset percentage upon request by the IRS. See section 6001.

IV. Annual Determination of Specified Person’s Interest in a Domestic Partnership

Proposed § 1.6038D-6(a) provides that whether a domestic partnership is a specified domestic entity is determined annually, and proposed § 1.6038D-6(b)(3)(ii) provides that a partnership is closely held if at least 80 percent of the capital or profits interest in the partnership is held directly, indirectly, or constructively by a specified individual on the last day of the partnership’s taxable year.

A commenter recommended that a partner’s interest in a partnership should be calculated on a year-by-year basis for purposes of determining whether a domestic partnership is a specified domestic entity. The comment noted that it is often difficult to determine the precise capital or profits interest of a partner because it may shift depending on the performance of the partnership.

The requirement to determine a partner’s capital or profits interest on a partic-

ular day is present in other provisions of the Internal Revenue Code, Treasury regulations, and published guidance, and the Treasury Department and the IRS believe it is an appropriate measure of an individual's economic interest in a partnership and, in general, is not overly complex. Accordingly, these final regulations retain the rule in the proposed regulations for determining if a domestic partnership is closely held.

V. Clarification to Aggregation Rules

Proposed § 1.6038D-6(b)(4) provides aggregation rules for purposes of applying proposed § 1.6038D-6(b)(1)(i), the § 1.6038D-2(a)(1) reporting threshold, and the passive income and asset thresholds under proposed § 1.6038D-6(b)(1)(iii). The proposed regulations provide that, for purposes of applying proposed § 1.6038D-6(b)(1)(i) and the reporting threshold, all domestic corporations and domestic partnerships that have an interest in specified foreign financial assets and are closely held by the same specified individual are treated as a single entity, and each such related corporation or partnership is treated as owning the specified foreign financial assets held by all such related corporations or partnerships. Similarly, the proposed regulations provide that, for purposes of applying the passive income and asset thresholds, all domestic corporations and domestic partnerships that are closely held by the same specified individual and connected through stock or partnership interest ownership with a common parent corporation or partnership are treated as a single entity, and each member of such a group is treated as owning the combined assets and receiving the combined income of all members of that group.

The Treasury Department and the IRS have determined that it is not necessary both to treat a group as a single entity and to attribute the assets or income of members of the group to an entity. Therefore, these final regulations simplify the aggregation rules by eliminating the reference to treating all domestic corporations and partnerships as a single entity.

VI. Domestic Trusts

Proposed § 1.6038D-6(c) provides that a trust described in section 7701(a)(30)(E) is a specified domestic entity if and only if the trust has one or more specified persons as a current beneficiary. The term current beneficiary means, with respect to the taxable year, any person who at any time during such taxable year is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year). The Treasury Department and the IRS intend that a specified domestic entity include a trust whereby a specified person has an immediately exercisable general power of appointment, even if such specified person is not technically a beneficiary. Therefore, these final regulations clarify that the term current beneficiary also includes any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the taxable year, but does not include any holder of a general power of appointment that is exercisable only on the death of the holder.

VII. Expanding the Exceptions for Domestic Entities

Proposed § 1.6038D-6(d) excepts certain entities from being treated as a specified domestic entity. A commenter recommended that the final regulations expand proposed § 1.6038D-6(d) to also except certain domestic trusts that are not required to file a Form 1041, "U.S. Fiduciary Income Tax Return," or any information returns. The Treasury Department and the IRS do not adopt this comment because the 2014 final regulations already address the commenter's concerns. The 2014 final regulations provide in § 1.6038D-2(a)(7) that a specified person, including a specified domestic entity, is not required to file Form 8938, "Statement of Specified Foreign Financial Assets," with respect to a taxable year if the specified person is not required to file an annual return with the IRS with respect to that taxable year. In the case of a specified domestic entity, the term "annual return"

means an annual federal income tax return or information return filed with the IRS, including returns required under section 6012. See § 1.6038D-1(a)(11). A Form 1041 is an annual return for purposes of § 1.6038D-1(a)(11) of the final regulations.

A commenter recommended that the final regulations except publicly traded partnerships from being specified domestic entities because they are similar to publicly traded corporations described in section 1473(3), which are excepted from the definition of specified domestic entity under proposed § 1.6038D-6(d)(1). The Treasury Department and the IRS do not adopt this comment. The requirement under proposed § 1.6038D-6(b) that to be a specified domestic entity at least 80 percent of the capital or profits interest in a partnership must be held by a specified individual on the last day of the partnership's taxable year establishes appropriate general criteria that, as a practical matter, should exempt most publicly traded partnerships from being specified domestic entities.

A commenter recommended that the final regulations except an employer trust established for the benefit of more than a minimum number of employees, such as 50, from being a specified domestic entity even if the employer trust holds stock of a foreign company. The Treasury Department and the IRS believe the exception under proposed § 1.6038D-6(d)(1) for domestic entities that are not "specified United States persons" pursuant to section 1473(3), together with the exception for trusts whose trustees satisfy the supervisory oversight requirements and the income tax and information return filing requirements under proposed § 1.6038D-6(d)(2), are sufficiently broad to except employer trusts that represent a low risk of tax avoidance from characterization as a specified domestic entity. Therefore, this comment is not adopted.

Special Analyses

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

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). In the case of domestic corporations and partnerships, these regulations apply only when two separate tests are met. The first requires that at least 80 percent of the entity must be owned, directly, indirectly, or constructively, by a specified individual, generally a U.S. citizen or resident. The second test compares the entity's business income and assets with its passive income and assets. If more than 50 percent of the entity's annual gross income for the year is active business income and more than 50 percent of its assets for the taxable year are assets that produce or are held for the production of active income, then the entity is not subject to the reporting requirements under section 6038D. This two-part test reduces the burden imposed by these final regulations on domestic small business entities because closely-held domestic corporations and partnerships that are predominantly engaged in an active business generally will be excluded from reporting. Furthermore, small not-for-profit organizations that are tax-exempt under section 501(a) of the Internal Revenue Code and small governmental jurisdictions are not subject to these regulations.

For closely-held domestic corporations and partnerships that meet both tests, these final regulations limit the burden imposed. First, reporting is required only when the aggregate value of the entity's interests in specified foreign financial assets exceeds the reporting threshold under § 1.6038D-2(a)(1). Second, the final regulations exclude the value of specified foreign financial assets reported on one or more of the following forms from being taken into consideration in determining whether the small entity satisfies the reporting threshold under § 1.6038D-2(a)(1): Form 3520, "Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"; Form 3520-A, "Annual Information Return of Foreign Trust With a U.S. Owner"; Form 5471, "Information Return of U.S. Persons With Respect To Certain Foreign Corporations"; Form 8621, "Information Return by a Shareholder of a Passive For-

eign Investment Company or Qualified Electing Fund"; or Form 8865, "Return of U.S. Persons With Respect to Certain Foreign Partnerships." Third, small entities that hold specified foreign financial assets generally will be excepted from reporting such assets if the assets are reported on one or more of these forms, thereby further limiting the burden imposed by the final regulations on small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry for § 1.6038D-6 in numerical order to read in part as follows:

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

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

Par. 2. Section 1.6038D-0 is amended by:

1. Revising the entry for § 1.6038D-1(a)(12).
2. Adding entries for § 1.6038D-2(a)(6)(i) and (ii).
3. Revising the entry for § 1.6038D-6.

The revisions and additions read as follows:

§ 1.6038D-0 Outline of regulation provisions

* * * * *

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

(a) * * *
* * * * *

(12) Specified domestic entity.
* * * * *

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

(a) * * *
* * * * *

(6) * * *

(i) Specified individual.

(ii) Specified domestic entity.

* * * * *

§ 1.6038D-6 Specified domestic entities.

(a) Specified domestic entity.

(b) Corporations and partnerships.

(1) Formed or availed of.

(2) Closely held.

(i) Domestic corporation.

(ii) Domestic partnership.

(iii) Constructive ownership.

(3) Determination of passive income and assets.

(i) Definition of passive income.

(ii) Exception from passive income treatment for dealers.

(iii) Related entities.

(4) Examples.

(c) Domestic trusts.

(d) Excepted domestic entities.

(1) Certain persons described in section 1473(3).

(2) Certain domestic trusts.

(3) Domestic trusts owned by one or more specified persons.

(e) Effective/applicability dates.

* * * * *

Par. 3. Section 1.6038D-1(a)(12) is revised to read as follows:

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

(a) * * *
* * * * *

(12) Specified domestic entity. The term *specified domestic entity* has the meaning set forth in § 1.6038D-6.

* * * * *

Par. 4. Section 1.6038D-2 is amended by:

1. Redesignating the text of paragraph (a)(6) as paragraph (a)(6)(i) and adding a paragraph heading to newly redesignated paragraph (a)(6)(i).

2. Adding paragraph (a)(6)(ii).

3. Revising paragraph (g).

The additions and revision read as follows:

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

(a) * * *

(6) *Aggregate value calculation in case of specified foreign financial asset excluded from reporting*—(i) *Specified individual*. * * *

(ii) *Specified domestic entity*. The value of any specified foreign financial asset in which a specified domestic entity has an interest and that is excluded from reporting on Form 8938 pursuant to § 1.6038D-7(a) (concerning certain assets reported on another form) is excluded for purposes of determining the aggregate value of specified foreign financial assets. For purposes of determining the aggregate value of specified foreign financial assets, a specified domestic entity that is a corporation or partnership and that has an interest in any specified foreign financial asset is treated as owning all the specified foreign financial assets (excluding specified foreign financial assets excluded from reporting on Form 8938 pursuant to § 1.6038D-7(a)) held by all domestic corporations and domestic partnerships that are closely held by the same specified individual as determined under § 1.6038D-6(b)(2).

* * * * *

(g) *Effective/applicability dates*. This section, with the exception of § 1.6038D-2(a)(6)(ii), applies to taxable years ending after December 19, 2011. Section 1.6038D-2(a)(6)(ii) applies to taxable years beginning after December 31, 2015. Taxpayers may elect to apply the rules of this section, with the exception of § 1.6038D-2(a)(6)(ii), to taxable years ending on or prior to December 19, 2011.

Par 5. Section 1.6038D-6 is added to read as follows:

§ 1.6038D-6 Specified domestic entities.

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

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

(i) The corporation or partnership is closely held by a specified individual as determined under paragraph (b)(2) of this section; and

(ii) At least 50 percent of the corporation's or partnership's gross income for the taxable year is passive income or at least 50 percent of the assets held by the corporation or partnership for the taxable year are assets that produce or are held for the production of passive income as determined under paragraph (b)(3) of this section (passive assets). For purposes of this paragraph (b)(1)(ii), the percentage of passive assets held by a corporation or partnership for a taxable year is the weighted average percentage of passive assets (weighted by total assets and measured quarterly), and the value of assets of a corporation or partnership is the fair market value of the assets or the book value of the assets that is reflected on the corporation's or partnership's balance sheet (as determined under either a U.S. or an international financial accounting standard).

(2) *Closely held*—(i) *Domestic corporation*. A domestic corporation is closely held by a specified individual if at least 80 percent of the total combined voting power of all classes of stock of the corporation entitled to vote, or at least 80 percent of the total value of the stock of the corporation, is owned, directly, indirectly, or constructively, by a specified individual

on the last day of the corporation's taxable year.

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

(iii) *Constructive ownership*. For purposes of this paragraph (b)(2), sections 267(c) and (e)(3) apply for the purpose of determining the constructive ownership of a specified individual in a corporation or partnership, except that section 267(c)(4) is applied as if the family of an individual includes the spouses of the individual's family members.

(3) *Determination of passive income and assets*—(i) *Definition of passive income*. Except as provided in paragraph (b)(3)(ii) of this section, for purposes of paragraph (b)(1)(ii) of this section, passive income means the portion of gross income that consists of—

(A) Dividends, including substitute dividends;

(B) Interest;

(C) Income equivalent to interest, including substitute interest;

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

(E) Annuities;

(F) The excess of gains over losses from the sale or exchange of property that gives rise to passive income described in paragraphs (b)(3)(i)(A) through (b)(3)(i)(E) of this section;

(G) The excess of gains over losses from transactions (including futures, forwards, and similar transactions) in any commodity, but not including—

(1) Any commodity hedging transaction described in section 954(c)(5)(A), determined by treating the corporation or partnership as a controlled foreign corporation; or

(2) Active business gains or losses from the sale of commodities, but only if substantially all the corporation or partnership's commodities are property described in paragraph (1), (2), or (8) of section 1221(a);

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

(I) Net income from notional principal contracts as defined in § 1.446-3(c)(1).

(ii) *Exception from passive income treatment for dealers.* Notwithstanding paragraph (b)(3)(i) of this section, in the case of a corporation or partnership that regularly acts as a dealer in property described in paragraph (b)(3)(i)(F) of this section (referring to the sale or exchange of property that gives rise to passive income), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), the term passive income does not include—

(A) Any item of income or gain (other than any dividends or interest) from any transaction (including hedging transactions and transactions involving physical settlement) entered into in the ordinary course of such dealer's trade or business as such a dealer; and

(B) If such dealer is a dealer in securities (within the meaning of section 475(c)(2)), any income from any transaction entered into in the ordinary course of such trade or business as a dealer in securities.

(iii) *Related entities.* For purposes of applying the passive income and asset thresholds of paragraph (b)(1)(ii) of this section, all domestic corporations and domestic partnerships that are closely held by the same specified individual as determined under paragraph (b)(2) of this section and that are connected through stock or partnership interest ownership with a common parent corporation or partnership are treated as owning the combined assets and receiving the combined income of all members of that group. For purposes of the preceding sentence, assets relating to any contract, equity, or debt existing between members of such a group, as well as any items of gross income arising under or from such contract, equity, or debt, are eliminated. A domestic corporation or a domestic partnership is considered connected through stock or partnership interest ownership with a common parent corporation or partnership if stock representing at least 80 percent of the total

combined voting power of all classes of stock of the corporation entitled to vote or of the value of such corporation, or partnership interests representing at least 80 percent of the profits interests or capital interests of such partnership, in each case other than stock of or partnership interests in the common parent, is owned by one or more of the other connected corporations, connected partnerships, or the common parent.

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

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

(ii) *Closely held ownership determination.* A is considered to own 90% and 81% of the total value of DC1 and DC2, respectively, by application of the rules of section 267(c) and this section. DC1 and DC2 are closely held by A within the meaning of paragraph (b)(2) of this section because A, a specified individual, is considered to own more than 80% of their total value.

Example 2. Application of aggregation rule and reporting threshold. (i) *Facts.* L is a specified individual. In Year X, L wholly owns DC1, a domestic corporation, and also owns a 90% capital interest in DP, a domestic partnership. DC1 owns 80% of the sole class of stock of DC2, a domestic corporation. DC1 has no assets other than its interest in DC2. DC2's only assets are assets that produce passive income, with a maximum value in Year X of \$40,000 on October 12. DC2's assets are comprised in relevant part of specified foreign financial assets with a maximum value in Year X of \$15,000 on October 12. DP's only assets are assets that produce passive income and that are specified foreign financial assets with a maximum value of \$90,000 in Year X on October 12.

(ii) *Specified domestic entity status—(A) DC1 and DC2.* DC1 and DC2 are closely held by a specified individual for purposes of paragraph (b)(2) of this section. DC1 and DC2 are considered related entities that are connected through stock ownership with a common parent corporation under paragraph (b)(3)(iii) of this section, because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 through DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, for purposes of applying paragraph (b)(1)(ii) of this section, each of DC1 and DC2 is considered as owning the combined assets, and receiving the combined income, of both DC1 and DC2; however, DC1's equity interest in DC2 is disregarded for this purpose under paragraph (b)(3)(iii) of this section. Therefore, DC1 and DC2 each satisfies the passive asset threshold of para-

graph (b)(1)(ii) of this section, because 100 percent of each company's assets is passive. DC1 and DC2 are specified domestic entities for Year X.

(B) *DP.* DP is closely held by a specified individual for purposes of paragraph (b)(2) of this section. DP is not considered a related entity with DC1 and DC2 under paragraph (b)(3)(iii) of this section, because DC1 and DP are not owned by a common parent corporation or partnership. As a result, whether the passive income or passive asset threshold of paragraph (b)(1)(ii) of this section is met with respect to DP is determined solely by reference to DP's separately earned passive income and separately held passive assets. DP holds only passive assets during Year X and therefore satisfies paragraph (b)(1)(ii) of this section. DP is a specified domestic entity for Year X.

(iii) *Reporting requirements—(A) DC1.* Under § 1.6038D-2(a)(6)(ii), DC1 is not treated as owning the specified foreign financial assets held by DC2 and DP for purposes of applying the reporting threshold of § 1.6038D-2(a)(1), because DC1 does not have an interest in any specified foreign financial assets. DC1 is not required to file Form 8938 because DC1 does not satisfy the reporting threshold of § 1.6038D-2(a)(1).

(B) *DC2 and DP.* Under § 1.6038D-3, DC2 and DP each has an interest in specified foreign financial assets. For purposes of applying the reporting threshold of § 1.6038D-2(a)(1), § 1.6038D-2(a)(6)(ii) provides that DC2 is treated as owning in addition to its own assets the assets of DP, and DP is treated as owning in addition to its own assets the assets of DC2. As a result, DC2 and DP each satisfies the reporting threshold of § 1.6038D-2(a)(1), because the value of the specified foreign financial assets each is considered as owning for purposes of § 1.6038D-2(a)(1) is \$105,000 on October 12, Year X, which exceeds DC2's and DP's \$75,000 reporting threshold. DC2 and DP must each file Form 8938 for Year X to report their respective specified foreign financial assets in which they have an interest and disclose their maximum values as provided in § 1.6038D-4 (\$15,000 in the case of DC2 and \$90,000 in the case of DP).

Example 3. Application of aggregation rule and entity with an active trade or business. (i) *Facts.* The facts are the same as in *Example 2*, except that DC2 also owns an active business. The assets attributable to the business are not passive assets and constitute at least 60% of the value of DC2's assets at all times during Year X. The income from the business is not passive income and constitutes at least 60% of the gross income generated by DC2 in Year X.

(ii) *Specified domestic entity status—(A) DC1 and DC2.* DC1 and DC2 are considered related entities that are connected through stock ownership with a common parent corporation under paragraph (b)(3)(iii) of this section because DC1 and DC2 are closely held by L, and DC2 is connected with DC1 though DC1's ownership of stock of DC2 representing at least 80% of the voting power or value of DC2. As a result, for purposes of applying paragraph (b)(1)(ii) of this section, each of DC1 and DC2 is treated as owning the combined assets, and receiving the combined income, of both DC1 and DC2; however, DC1's equity interest in DC2 is disregarded for this purpose under paragraph (b)(3)(iii) of this sec-

tion. As a result, no more than 40 percent of the value of DC1's and DC2's assets at all times during Year X are passive and no more than 40 percent of DC1's and DC2's gross income for Year X is passive. DC1 and DC2 do not satisfy the passive income or passive asset threshold in paragraph (b)(1)(ii) of this section for Year X. DC1 and DC2 are not specified domestic entities for Year X.

(B) *DP*. For the reasons described in paragraph (ii)(B) of *Example 2*, DP is a specified domestic entity for Year X.

(iii) *Reporting requirements*—(A) *DC1 and DC2*. DC1 and DC2 are not specified domestic entities for Year X, and are not required to file Form 8938.

(B) *DP*. Under § 1.6038D-3, DP has an interest in specified foreign financial assets. Under § 1.6038D-2(a)(6)(ii), DP is treated as owning in addition to its own assets the assets of DC2. As a result, DP satisfies the reporting threshold of § 1.6038D-2(a)(1) because the value of the specified foreign financial assets it is considered to own for purposes of § 1.6038D-2(a)(1) is \$105,000 on October 12, Year X, which exceeds DP's \$75,000 reporting threshold. DP must file Form 8938 for Year X to report the specified foreign financial assets in which it has an interest and disclose their maximum values as provided in § 1.6038D-4, which is \$90,000.

(c) *Domestic trusts*. Except as otherwise provided in paragraph (d) of this section, a trust described in section 7701(a)(30)(E) is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets if and only if the trust has one or more specified persons as a current beneficiary. The term current beneficiary means, with respect to the taxable year, any person who at any time during such taxable year is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year). The term current beneficiary also includes any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the taxable year, but does not include any holder of a general power of appointment that is exercisable only on the death of the holder.

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

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

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

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

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

(iii) Is —

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

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

(C) A domestic corporation described in section 1473(3)(A) or (B), and the regulations issued with respect to those provisions.

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

(e) *Effective/applicability dates*. This section applies to taxable years beginning after December 31, 2015.

Karen M. Schiller,
Deputy Commissioner for
Services and Enforcement.

Approved: January 19, 2016.

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

(Filed by the Office of the Federal Register on February 22, 2016, 8:45 a.m., and published in the issue of the Federal Register for February 23, 2016, 81 F.R. 03795)

Section 1274.— Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Rev. Rul. 2016-07

This revenue ruling provides various prescribed rates for federal income tax purposes for March 2016 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2016-07 TABLE 1
Applicable Federal Rates (AFR) for March 2016
Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
		<i>Short-term</i>		
AFR	.65%	.65%	.65%	.65%
110% AFR	.72%	.72%	.72%	.72%
120% AFR	.78%	.78%	.78%	.78%
130% AFR	.85%	.85%	.85%	.85%
		<i>Mid-term</i>		
AFR	1.48%	1.47%	1.47%	1.47%
110% AFR	1.63%	1.62%	1.62%	1.61%
120% AFR	1.77%	1.76%	1.76%	1.75%
130% AFR	1.92%	1.91%	1.91%	1.90%
150% AFR	2.22%	2.21%	2.20%	2.20%
175% AFR	2.59%	2.57%	2.56%	2.56%
		<i>Long-term</i>		
AFR	2.33%	2.32%	2.31%	2.31%
110% AFR	2.57%	2.55%	2.54%	2.54%
120% AFR	2.80%	2.78%	2.77%	2.76%
130% AFR	3.04%	3.02%	3.01%	3.00%

REV. RUL. 2016-07 TABLE 2
Adjusted AFR for March 2016
Period for Compounding

	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	.55%	.55%	.55%	.55%
Mid-term adjusted AFR	1.12%	1.12%	1.12%	1.12%
Long-term adjusted AFR	2.27%	2.26%	2.25%	2.25%

REV. RUL. 2016-07 TABLE 3
Rates Under Section 382 for March 2016

Adjusted federal long-term rate for the current month	2.27%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	2.65%

REV. RUL. 2016-07 TABLE 4
Appropriate Percentages Under Section 42(b)(1) for March 2016

Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.44%
Appropriate percentage for the 30% present value low-income housing credit	3.19%

REV. RUL. 2016-07 TABLE 5
Rate Under Section 7520 for March 2016

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	1.8%
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Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2016. See Rev. Rul. 2016–07, page 391.

Part III. Administrative, Procedural, and Miscellaneous

Note. This revenue procedure will be reproduced as the next revision of IRS Publication 4436, General Rules and Specifications for Substitute Form 941, Schedule B (Form 941), Schedule D (Form 941), and Schedule R (Form 941).

Rev. Proc. 2016-16

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Part 1

Section 1.1 – Purpose

.01 The purpose of this revenue procedure is to provide general rules and specifications from the IRS for paper and computer-generated substitutes for Form 941, Employer’s QUARTERLY Federal Tax Return; Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors (referred to in this revenue procedure as “Schedule B”); Schedule D (Form 941), Report of Discrepancies Caused by Acquisitions, Statutory Mergers, or Consolidations (referred to in this revenue procedure as “Schedule D”); and Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers (referred to in this revenue procedure as “Schedule R”).

Note. Substitute territorial forms (941-PR, Planilla para la Declaración Federal TRIMESTRAL del Patrono; 941-SS, Employer’s QUARTERLY Federal Tax Return (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands); and Anexo B (Formulario 941-PR), Registro de la Obligación Contributiva para los Despositantes de Itinerario Bisemanal) should also conform to the specifications outlined in this revenue procedure.

.02 This revenue procedure provides information for substitute Form 941, Schedule B, Schedule D, and Schedule R. If you need more in-depth information on who must complete these forms and how to complete them, see the Instructions for Form 941, Instructions for Schedule B, Instructions for Schedule D, instructions included with Schedule R, and Pub. 15, Employer’s Tax Guide, or visit IRS.gov.

Note. Failure to produce acceptable substitutes of the forms and schedules listed in this revenue procedure may result in delays in processing and penalties.

.03 Forms that completely follow the guidelines in this revenue procedure and are exact replicas of the official IRS forms do not need to be submitted to the IRS for specific approval. Substitute forms and schedules need to be scanned using IRS scanning equipment.

If you are uncertain of any specification and want clarification, do the following.

1. Submit a letter citing the specification.
2. State your understanding of the specification.
3. Enclose an example (if appropriate) of how the form would appear if produced using your understanding.
4. Be sure to include your name, complete address, phone number, and, if applicable, your email address with your correspondence. Send your request to *SCRIPS@irs.gov* or *substituteforms@irs.gov*, or use the following address.

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:P:TP
5000 Ellin Road, C6-440
Lanham, MD 20706

Note. Allow at least 30 days for the IRS to respond.

.04 However, software developers and form producers should send a blank copy of their substitute Form 941 and Schedule B in Portable Document Format (PDF) to *SCRIPS@irs.gov*. The purpose is not specifically for approval but to assist the IRS in preparing to scan these forms. Submitters will only receive comments if a significant problem is discovered through this process. Submitters are not expected to delay marketing their forms in order to receive feedback. Submitters must not include any “live” taxpayer data on any substitute form submitted for review.

.05 The following six-digit form ID codes are used on Form 941 and the schedules for Form 941.

- **Official paper forms:** 950114 (Form 941, page 1); 950214 (Form 941, page 2); 960311 (Schedule B); 950413 (Schedule R, page 1); 950513 (Schedule R, page 2); and 950613 (Schedule R, page 3).
- **Substitute 6x10 grids:** 970114 (Form 941, page 1); 970214 (Form 941, page 2); 970311 (Schedule B); 970413 (Schedule R, page 1); 970513 (Schedule R, page 2); and 970613 (Schedule R, page 3).

Generally, the last two digits of the form ID code represent the last year in which the IRS made major formatting changes to the layout of the form.

Note. Page 3 of Schedule R is not required to be filed with the IRS as part of a substitute Schedule R. However, if page 3 of the substitute Schedule R is filed, it must include the form ID code.

.06 This revenue procedure will be updated only if there are major formatting changes to the layout of the forms or there are other changes that impact the processing of substitute forms.

Section 1.2 – General Requirements for Reproducing IRS Official Form 941, Schedule B, Schedule D, and Schedule R

.01 Submit substitute Form 941, Schedule B, Schedule D, and Schedule R to the IRS for specifications review. Substitute Form 941, Schedule B, Schedule D, and Schedule R that **completely conform** to the specifications contained in this revenue procedure do not require prior approval from the IRS, but should be submitted to *SCRIPS@irs.gov* to ensure that they conform to IRS format and scanning specifications.

.02 Print the form on standard 8.5 inches wide by 11-inch paper.

.03 Use white paper that meets generally accepted weight, color, and quality standards (minimum 20 lb. white bond paper).

Note. Reclaimed fiber in any percentage is permitted provided that the requirements of this standard are met.

.04 The IRS prefers printing Form 941 on both sides of a single sheet of paper, but it is acceptable to print on one side of each of two separate sheets of paper.

.05 Make the substitute paper form as identical to the official form as possible.

.06 Print the substitute form using nonreflective black (not blue or other-colored) ink. Printing in an ink color other than black may reduce readability in the scanning process. This may result in figures being too faint to be recognizable.

.07 Use typefaces that are substantially identical in size and shape to the official form and use rules and shading (if used) that are substantially identical to those on the official form. Use font size as large as possible within the fields.

.08 Print the six-digit form ID code (if one exists on the official form) in the upper right-hand corner of each form using nonreflective black, carbon-based, 12-point. The use of non-OCR-A font may reduce readability for scanning. Use the official form to develop your substitute form.

Note. Maintain as much white space as possible around the form ID code. Do not allow character strings to print adjacent to the code.

The year digits represent the last year in which the IRS made major formatting changes to the layout of the form. Therefore, the last two digits may not be the same as the current tax year. For tax year 2016 and until this revenue procedure is superseded, print “950114” on Form 941, page 1; “950214” on Form 941, page 2; “960311” on Schedule B; “950413” on Schedule R, page 1; “950513” on Schedule R, page 2; and “950613” on Schedule R, page 3. See *Section 1.3* for information on form ID codes for software-generated forms.

Note. Page 3 of Schedule R is not required to be filed with the IRS as part of a substitute Schedule R. However, if page 3 of the substitute Schedule R is filed, it must include the form ID code.

.09 Print the OMB number in the same location as on the official form. Be sure to include the OMB number on Form 941, Schedule B, Schedule D, and Schedule R.

.10 Print all entry boxes and checkboxes exactly as shown (**location and size**) on the official forms.

Note. Instead of a four-sided checkbox for the entry, just the bottom line of the box can be used as long as the location and size remain the same.

.11 Print “For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher.” at the bottom of page 1 of Form 941.

.12 Print “For Paperwork Reduction Act Notice, see separate instructions.” at the bottom of Schedule B and Schedule D. Print “For Paperwork Reduction Act Notice, see the instructions.” at the bottom of Schedule R.

.13 Do not print the form catalog number (“Cat. No.”) at the bottom of the forms or instructions. Instead, print your IRS-issued three letter substitute form source code in place of the catalog number on the left at the bottom of page 1 of Form 941, Schedule B, Schedule D, and Schedule R.

Note. You can obtain a three-letter substitute form source code by requesting it by email at substituteforms@irs.gov. Please enter “Substitute Forms” on the subject line.

.14 Do not print the Government Printing Office (GPO) symbol at the bottom of the forms or instructions.

Section 1.3 – Reproducing Form 941, Schedule B, Schedule D, and Schedule R for Software-Generated Paper Forms

.01 You may use the PDF files to develop the layout for your forms. Draft forms found at www.irs.gov/app/picklist/list/draftTaxForms.html can be used to develop interim formats until the forms are finalized. When forms become finalized, they are posted and can be found at www.irs.gov/app/picklist/list/formsPublications.html. You may use 6x10 grid formats to develop software versions of Form 941, Schedule B, Schedule D, and Schedule R. Please follow the specifications exactly to develop the fields.

.02 If you are developing software using the 6x10 grid, you may make the following modifications.

- “970114” for Form 941, page 1; “970214” for Form 941, page 2; “970311” for Schedule B; “970413” for Schedule R, page 1; “970513” for Schedule R, page 2; and “970613” for Schedule R, page 3, as the form ID codes.

Note. Maintain as much white space as possible around the form ID code. Do not allow character strings to print adjacent to the code.

- Place all 6x10 grid boxes and entry spaces in the same field locations as indicated on the official forms.
- Use single lines for “Employer Identification Number (EIN)” and other entry areas in the entity section of Form 941, page 1; Schedule B; and Schedule R, pages 1 and 2.
- Reverse type is not needed as shown on the official form.
- **Do not** pre-print decimal points in the data boxes. However, where the amounts are required, the amounts should be printed with decimal points and place holders for cents.
- Delete the pre-printed formatting in any “date” boxes.
- Use a single box for “Personal Identification Number (PIN)” on Form 941.
- You may delete all shading when using the 6x10 grid format.

.03 If producing both the form and the data or the form only, print your three-letter source code at the bottom of Form 941, page 1; Schedule B; Schedule D; or Schedule R, page 1. See *Section 1.2.13*.

.04 If producing only the data on the form, print your four-digit software industry vendor code on Form 941. The four-digit vendor code preceded by four zeros and a slash (0000/9876) must be pre-printed. If you have a valid vendor code issued to you through the National Association of Computerized Tax Processors (NACTP), you should use that code. If you do not have a valid vendor code, contact the NATCP via email at president@natcp.org for information on these codes.

.05 Print “For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher.” at the bottom of Form 941, page 1.

.06 Print “For Paperwork Reduction Act Notice, see separate instructions.” at the bottom of Schedule B and Schedule D.

.07 Print “For Paperwork Reduction Act Notice, see the instructions.” at the bottom of Schedule R, page 1.

.08 Be sure to print the OMB number in the same location as on the official forms on substitute Form 941, Schedule B, Schedule D, and Schedule R.

.09 Do not print the form catalog number (“Cat. No.”) at the bottom of the forms or instructions.

.10 Do not print the Government Printing Office (GPO) symbol at the bottom of the forms or instructions.

.11 To ensure accurate scanning and processing, enter data on Form 941, Schedule B, Schedule D, and Schedule R as follows.

- Display/print the name and EIN on all pages and attachments in the proper associated fields.
- Use 12-point (minimum 10-point) Courier font (where possible).
- Omit dollar signs, but use commas when showing amounts.
- Except for Form 941, lines 1 and 2, leave blank any data field with a value of zero.
- Enter negative amounts with a minus sign. For example, report “-10.59” instead of “(10.59).”

Note. The IRS prefers that you use a minus sign for negative amounts instead of parentheses or some other means. However, if your software only allows for parentheses in reporting negative amounts, you may use them.

Section 1.4 – Specific Instructions for Schedule D

.01 To properly file and to reduce delays and contact from the IRS, Schedule D must be produced as closely as possible to the official form.

.02 Use Schedule D to explain why you have certain discrepancies. See the Instructions for Schedule D for more information. In many cases, the information on Schedule D helps the IRS resolve discrepancies without contacting you.

.03 If a substitute Schedule D is not submitted in similar format to the official IRS schedule, the substitutes may be returned, you may be contacted by the IRS, delays in processing may occur, and you may be subject to penalties.

Section 1.5 – Specific Instructions for Schedule R

.01 To properly file and to reduce delays and contact from the IRS, Schedule R must be produced as closely as possible to the official form.

Note. Do not present the information in spreadsheet or similar format. We may not be able to properly process nonconforming documents with an excessive number of entries. Complete as many Continuation Sheets for Schedule R (Schedule R, page 2) as necessary. If Continuation Sheets are not used or they vary in form from the official form, processing may be delayed and you may be subject to penalties.

.02 Use Schedule R to allocate the aggregate information reported on Form 941 to each client. If you have more than 15 clients, complete as many Continuation Sheets for Schedule R as necessary. Attach Schedule R, including any Continuation Sheets, to your aggregate Form 941 and file it with your return. Enter your business information carefully.

Make sure all information exactly matches the information shown on the aggregate Form 941. Compare the total of each column on Schedule R, line 19 (including your information on line 18), to the amounts reported on the aggregate Form 941. For each column total of Schedule R, the relevant line from Form 941 is noted in the column heading. If the totals on Schedule R, line 19, do not match the totals on Form 941, there is an error that must be corrected before submitting Form 941 and Schedule R.

.03 Do:

- Develop and submit only conforming Schedules R.
- Follow the format and fields exactly as on the official Schedule R.
- Maintain the same number of entry lines on the substitute Schedule R as on the official form.

.04 Do not:

- Add or delete entry lines.
- Submit spreadsheets, database printouts, or similar formatted documents instead of using the Schedule R format to report data.
- Reduce or expand font size to add or delete extra data or lines.

.05 If substitute Schedules R and Continuation Sheets for Schedule R are not submitted in similar format to the official schedule, the substitutes may be returned, you may be contacted by the IRS, delays in processing may occur, and you may be subject to penalties.

Section 1.6 – OMB Requirements for Substitute Forms

.01 The Paperwork Reduction Act (the Act) of 1995 (Public Law 104-13) requires the following.

- The Office of Management and Budget (OMB) approves all IRS tax forms that are subject to the Act.
- Each IRS form contains the OMB approval number, if assigned. The official OMB numbers may be found on the official IRS-printed forms.
- Each IRS form (or its instructions) states:
 1. Why the IRS needs the information,
 2. How it will be used, and
 3. Whether or not the information is required to be furnished to the IRS.

.02 This information must be provided to any users of official or substitute IRS forms or instructions.

.03 The OMB requirements for substitute IRS forms are the following.

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official form.
- For Form 941, Schedule B, Schedule D, and Schedule R, the OMB number (1545-0029) must appear exactly as shown on the official form. For Form 941, Schedule B, Schedule D, and Schedule R, the OMB number must use one of the following formats.
 1. OMB No. 1545–0029 (preferred).
 2. OMB # 1545–0029 (acceptable).

.04 If no instructions are provided to users of your forms, you must furnish to them the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 1.7 – Order Forms and Instructions

.01 You can order forms and instructions at www.irs.gov/orderforms.

Section 1.8 – Effect on Other Documents

.01 Revenue Procedure 2015–38, 2015–36 I.R.B. 295, dated September 7, 2015, is superseded.

Section 1.9 – Helpful Information

.01 Please follow the specifications and guidelines to produce substitute Form 941, Schedule B, Schedule D, and Schedule R.

.02 These forms are subject to review and possible changes as required. Therefore, employers are cautioned against overstocking supplies of privately printed substitutes.

.03 Here is a review of references that were listed throughout this document.

- Form 941, Employer's QUARTERLY Federal Tax Return.
- Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors (referred to in this revenue procedure as "Schedule B").
- Schedule D (Form 941), Report of Discrepancies Caused by Acquisitions, Statutory Mergers, or Consolidations (referred to in this revenue procedure as "Schedule D").
- Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers (referred to in this revenue procedure as "Schedule R").
- Substitute territorial forms (941-PR, 941-SS, and Anexo B (Formulario 941-PR)).
- Instructions for Form 941.
- Instructions for Schedule B (Form 941).
- Pub. 15, Employer's Tax Guide.
- *SCRIPS@irs.gov* for submissions.
- *Substituteforms@irs.gov* for questions.
- For questions:

Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:P:TP
5000 Ellin Road, C6-440
Lanham, MD 20706

- www.irs.gov/app/picklist/list/draftTaxForms.html for draft forms.
- www.irs.gov/app/picklist/list/formsPublications.html for final forms.

Section 1.10 – Exhibits

950214 .50*

Name (not your trade name) Employer identification number (EIN)

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you are unsure about whether you are a monthly schedule depositor or a semiweekly schedule depositor, see section 11 of Pub. 15.

- 14 Check one: Line 10 on this return is less than \$2,500 or line 10 on the return for the prior quarter was less than \$2,500, and you did not incur a \$100,000 next-day deposit obligation during the current quarter.
You were a monthly schedule depositor for the entire quarter.
You were a semiweekly schedule depositor for any part of this quarter.

Tax liability: Month 1, Month 2, Month 3, Total liability for quarter. Total must equal line 10.

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

- 15 If your business has closed or you stopped paying wages.
16 If you are a seasonal employer and you do not have to file a return for every quarter of the year.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS?
Yes. Designee's name and phone number. Select a 5-digit Personal Identification Number (PIN) to use when talking to the IRS.
No.

Part 5: Sign here. You MUST complete both pages of Form 941 and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign your name here. Print your name here. Print your title here. Date. Best daytime phone.

Paid Preparer Use Only. Preparer's name, signature, firm's name, address, city, state, ZIP code. Check if you are self-employed. PTIN, Date, EIN, Phone, ZIP code.

**Form 941-V,
Payment Voucher**

▼ **Detach Here and Mail With Your Payment and Form 941.** ▼

<p>Form 941-V Department of the Treasury Internal Revenue Service</p>	<p>Payment Voucher</p> <p>► Don't staple this voucher or your payment to Form 941.</p>	<p>OMB No. 1545-0029</p> <p style="font-size: 2em;">2016</p>				
<p>1 Enter your employer identification number (EIN).</p>	<p>2 Enter the amount of your payment. ► Make your check or money order payable to "United States Treasury"</p> <table style="width: 100%; border: none;"> <tr> <td style="width: 80%; border: none;">Dollars</td> <td style="width: 20%; border: none;">Cents</td> </tr> </table>	Dollars	Cents			
Dollars	Cents					
<p>3 Tax Period</p> <table style="width: 100%; border: none;"> <tr> <td style="width: 50%; border: none;"> <input type="radio"/> 1st Quarter 3.45 </td> <td style="width: 50%; border: none;"> <input type="radio"/> 3rd Quarter </td> </tr> <tr> <td style="border: none;"> <input type="radio"/> 2nd Quarter </td> <td style="border: none;"> <input type="radio"/> 4th Quarter </td> </tr> </table>	<input type="radio"/> 1st Quarter 3.45	<input type="radio"/> 3rd Quarter	<input type="radio"/> 2nd Quarter	<input type="radio"/> 4th Quarter	<p>4 Enter your business name (individual name if sole proprietor).</p> <p>Enter your address.</p> <p>Enter your city, state, and ZIP code or your city, foreign country name, foreign province/county, and foreign postal code.</p>	
<input type="radio"/> 1st Quarter 3.45	<input type="radio"/> 3rd Quarter					
<input type="radio"/> 2nd Quarter	<input type="radio"/> 4th Quarter					

7.50"

Schedule R (Form 941): Allocation Schedule for Aggregate Form 941 Filers

950413

OMB No. 1545-0029

(Rev. January 2014)

Department of the Treasury — Internal Revenue Service 5,00*

Employer identification number (EIN) 3.30*

Name as shown on Form 941 3.90*

Report for calendar year:

Check the quarter (same as Form 941):

1: January, February, March 2.40*

2: April, May, June

3: July, August, September 2.10*

4: October, November, December

Read the instructions before you complete Schedule R (Form 941). Type or print within the boxes. Complete a separate line for the amounts allocated to each of your clients.

(a) Client's Employer identification number (EIN)	(b) Wages, tips, and other compensation allocated to the listed client EIN from Form 941, line 2	(c) Federal income tax withheld from wages, tips, and other compensation allocated to the listed client EIN from Form 941, line 3	(d) Total social security and Medicare taxes allocated to the listed client EIN from Form 941, line 5e	(e) Section 3121(q) Notice and Demand- Tax due on unreported tips allocated to the listed client EIN from Form 941, line 5f	(f) Total taxes after adjustments allocated to the listed client EIN from Form 941, line 10	(g) Total deposits from Form 941, line 11, plus any payments made with the return allocated to the listed client EIN
1	.25*	.	.	.	.	.
2	.	.	.	.	.	.
3	.	.	.	.	.	.
4	1.10*	1.10*	1.10*	1.10*	.	.
5	.	.	.	.	.	.
6	.	.	.	.	.	.
7	.	.	.	.	.	.
8	7.50*				.	.
9	.	.	.	.	.	.
10	.	.	.	.	.	.
11	.	.	.	.	.	.
12	.	.	.	.	.	.
13	.	.	.	.	.	.
14	.	.	.	.	.	.
15	.	.	.	.	.	.
16	Subtotals for clients. Add all amounts on lines 1 through 15.					
	.50*	.	.	.	.	.
17	Enter the combined subtotal from line 26 of all Continuation Sheets for Schedule R (Form 941).					
	.	.83*	.	.	.	.
18	Enter Form 941 amounts for your employees.					
	.	.50*	.	.	.	.
19	Totals. Add lines 16, 17, and 18. The column totals must match the related lines on the aggregate Form 941.					
	.83*	.	.	.	.	.

For Paperwork Reduction Act Notice, see the instructions.

IRS.gov/form941

Cat. No. 49301K

Schedule R (Form 941) (Rev. 1-2014)

.80*

Continuation Sheet for Schedule R (Form 941)

(Rev. January 2014)

Employer identification number (EIN) 5.00*

Name as shown on Form 941 3.90*

3.30*

.50*

Report for calendar year:

Check the quarter (same as Form 941):

1: January, February, March 2.20*

2: April, May, June

3: July, August, September

4: October, November, December

(a) Client's Employer identification number (EIN)	(b) Wages, tips, and other compensation allocated to the listed client EIN from Form 941, line 2	(c) Federal income tax withheld from wages, tips, and other compensation allocated to the listed client EIN from Form 941, line 3	(d) Total social security and Medicare taxes allocated to the listed client EIN from Form 941, line 5e	(e) Section 3121(q) Notice and Demand- Tax due on unreported tips allocated to the listed client EIN from Form 941, line 5f	(f) Total taxes after adjustments allocated to the listed client EIN from Form 941, line 10	(g) Total deposits from Form 941, line 11, plus any payments made with the return allocated to the listed client EIN
1
2	1.10*	.	.	.	.	.
3
4	.25*	.	.	.	.	.
5
6
7
8
9
10
11	.	.	7.85*	.	.	.
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26	Subtotals for clients. Add lines 1 through 25. Include the subtotals from line 26 on line 17 of Schedule R (Form 941).	.58*				

Part IV. Items of General Interest

Announcement of Disciplinary Sanctions From the Office of Professional Responsibility

Announcement 2016–06

The Office of Professional Responsibility (OPR) announces recent disciplinary sanctions involving attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, appraisers, and unenrolled/unlicensed return preparers (individuals who are not enrolled to practice and are not licensed as attorneys or certified public accountants). Licensed or enrolled practitioners are subject to the regulations governing practice before the Internal Revenue Service (IRS), which are set out in Title 31, Code of Federal Regulations, Subtitle A, Part 10, and which are released as Treasury Department Circular No. 230. The regulations prescribe the duties and restrictions relating to such practice and prescribe the disciplinary sanctions for violating the regulations. Unenrolled/unlicensed return preparers are subject to Revenue Procedure 81–38 and superseding guidance in Revenue Procedure 2014–42, which govern a preparer’s eligibility to represent taxpayers before the IRS in examinations of tax returns the preparer both prepared for the taxpayer **and** signed as the preparer. Additionally, unenrolled/unlicensed return preparers who voluntarily participate in the Annual Filing Season Program under Revenue Procedure 2014–42 agree to be subject to the duties and restrictions in Circular 230, including the restrictions on incompetent or disreputable conduct.

The disciplinary sanctions to be imposed for violation of the applicable standards are:

Disbarred from practice before the IRS—An individual who is disbarred is not eligible to practice before the IRS as defined at 31 C.F.R. § 10.2(a)(4) for a minimum period of five (5) years.

Suspended from practice before the IRS—An individual who is suspended is not eligible to practice before the IRS as defined at 31 C.F.R. § 10.2(a)(4) during the term of the suspension.

Censured in practice before the IRS—Censure is a public reprimand. Un-

like disbarment or suspension, censure does not affect an individual’s eligibility to practice before the IRS, but OPR may subject the individual’s future practice rights to conditions designed to promote high standards of conduct.

Monetary penalty—A monetary penalty may be imposed on an individual who engages in conduct subject to sanction, or on an employer, firm, or entity if the individual was acting on its behalf and it knew, or reasonably should have known, of the individual’s conduct.

Disqualification of appraiser—An appraiser who is disqualified is barred from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the IRS.

Ineligible for limited practice—An unenrolled/unlicensed return preparer who fails to comply with the requirements in Revenue Procedure 81–38 or to comply with Circular 230 as required by Revenue Procedure 2014–42 may be determined ineligible to engage in limited practice as a representative of any taxpayer. Under the regulations, individuals subject to Circular 230 may not assist, or accept assistance from, individuals who are suspended or disbarred with respect to matters constituting practice (*i.e.*, representation) before the IRS, and they may not aid or abet suspended or disbarred individuals to practice before the IRS.

Disciplinary sanctions are described in these terms:

Disbarred by decision, Suspended by decision, Censured by decision, Monetary penalty imposed by decision, and Disqualified after hearing—An administrative law judge (ALJ) issued a decision imposing one of these sanctions after the ALJ either (1) granted the government’s summary judgment motion or (2) conducted an evidentiary hearing upon OPR’s complaint alleging violation of the regulations. After 30 days from the issuance of the decision, in the absence of an appeal, the ALJ’s decision becomes the final agency decision.

Disbarred by default decision, Suspended by default decision, Censured by default decision, Monetary penalty imposed by default decision, and Dis-

qualified by default decision—An ALJ, after finding that no answer to OPR’s complaint was filed, granted OPR’s motion for a default judgment and issued a decision imposing one of these sanctions.

Disbarment by decision on appeal, Suspended by decision on appeal, Censured by decision on appeal, Monetary penalty imposed by decision on appeal, and Disqualified by decision on appeal—The decision of the ALJ was appealed to the agency appeal authority, acting as the delegate of the Secretary of the Treasury, and the appeal authority issued a decision imposing one of these sanctions.

Disbarred by consent, Suspended by consent, Censured by consent, Monetary penalty imposed by consent, and Disqualified by consent—In lieu of a disciplinary proceeding being instituted or continued, an individual offered a consent to one of these sanctions and OPR accepted the offer. Typically, an offer of consent will provide for: suspension for an indefinite term; conditions that the individual must observe during the suspension; and the individual’s opportunity, after a stated number of months, to file with OPR a petition for reinstatement affirming compliance with the terms of the consent and affirming current fitness and eligibility to practice (*i.e.*, an active professional license or active enrollment status, with no intervening violations of the regulations).

Suspended indefinitely by decision in expedited proceeding, Suspended indefinitely by default decision in expedited proceeding, Suspended by consent in expedited proceeding—OPR instituted an expedited proceeding for suspension (based on certain limited grounds, including loss of a professional license for cause, and criminal convictions).

Determined ineligible for limited practice—There has been a final determination that an unenrolled/unlicensed return preparer is not eligible for limited representation of any taxpayer because the preparer violated standards of conduct or failed to comply with any of the requirements to act as a representative.

OPR has authority to disclose the grounds for disciplinary sanctions in these situations: (1) an ALJ or the Secretary’s delegate on appeal has issued a final deci-

sion; (2) the individual has settled a disciplinary case by signing OPR's "consent to sanction" agreement admitting to one or more violations of the regulations and consenting to the disclosure of the admitted violations (for example, failure to file Federal income tax returns, lack of due dili-

gence, conflict of interest, etc.); (3) OPR has issued a decision in an expedited proceeding for indefinite suspension; or (4) OPR has made a final determination (including any decision on appeal) that an unenrolled/unlicensed return preparer is ineligible to represent any taxpayer before the IRS.

Announcements of disciplinary sanctions appear in the Internal Revenue Bulletin at the earliest practicable date. The sanctions announced below are alphabetized first by state and second by the last names of the sanctioned individuals.

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
California				
Inglewood	Applewhite, Jeffery D.	CPA	Suspended by decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from November 5, 2015
Lake Elsinore	Schultz, Richard E.	Enrolled Agent	Suspended by default decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from October 21, 2015
	Schnur, Steven W., see Georgia			
Florida				
Bradenton	Penn, Joel	CPA	Suspended by default decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from November 3, 2015
Georgia				
Peachtree Corners	Schnur, Steven W.	CPA	Suspended by decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from October 6, 2015
Illinois				
Naperville	McMahon, Brian	CPA	Suspended by default decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from November 3, 2015
Massachusetts				
Scituate	Rogers, Jr., John J.	Attorney		Reinstated to practice before the IRS December 14, 2015
New Jersey				
	Penn, Joel, see Florida			
New York				
Hicksville	Napolitano, James	CPA		Reinstated to practice before the IRS December 14, 2015
North Carolina				
Raleigh	Howell, Robert	Attorney	Suspended by default decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from November 5, 2015
Oregon				
Tualatin	Phinney, William S.	Attorney	Suspended by decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from October 15, 2015

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Tennessee				
Mount Juliet	Haley, Robert W.	CPA	Suspended by default decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from November 5, 2015
Murfreesboro	Riddle, Mark S.	CPA	Suspended by decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from December 15, 2015

Notice of Disposition of Declaratory Judgment Proceedings under Section 7428

Announcement 2016-11

This announcement serves notice to donors that on February 2, 2016, the United States Tax Court entered a stipulated decision that the organization listed below is recognized as an organization described in section 501(c)(3) and is exempt from taxation under section 501(a) for taxable years beginning July 1, 2001.

Academy of America, a Michigan Non-Profit Corporation
Oak Park, MI

Requirements for Type I and Type III Supporting Organizations

REG-118867-10

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the prohibition on certain contributions to Type I and Type III supporting organizations and the requirements for Type III supporting organizations. The regulations reflect changes to the law made by the Pension Protection Act of 2006. The regulations will affect Type I and Type III supporting organizations and their supported organizations.

DATES: Written or electronic comments and requests for a public hearing must be received by May 19, 2016.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-118867-10), 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 8:00 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-118867-10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, 20224 or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS REG-118867-10).

FOR FURTHER INFORMATION

CONTACT: Concerning the proposed regulations, Jonathan Carter at (202) 317-5800 or Mike Repass at (202) 317-4086; concerning submissions of comments and requests for a public hearing, Regina Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review and approval in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS

Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by April 19, 2016.

Comments are specifically requested concerning:

- Whether the proposed collection of information is necessary for the proper performance of the functions 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 forms of information technology; and
- Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in these proposed regulations is in § 1.509(a)-4(i)(4)(iv)(D) (written record of close cooperation and coordination by the governmental supported organizations) and § 1.509(a)-4(i)(6)(iii)(B) (written record of contributions received by the supported organization). Requiring the supporting organization to collect written records of its governmental supported organizations' close cooperation and coordination with each other and written records of the contributions its supported organizations directly received in response to solicitations by the supporting organization permits the IRS to determine whether the supporting organization satisfies the requirements to be a functionally integrated or non-

functionally integrated Type III supporting organization. The record keepers are Type III supporting organizations.

Estimated number of recordkeepers: 7,872.

Estimated average annual burden hours per recordkeeper: 2 hours.

Estimated total annual recordkeeping burden: 15,744.

Estimated frequency of collection of such information: Annual.

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 return information are confidential, as required by 26 U.S.C. 6103.

Background

1. Overview

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) regarding organizations described in section 509(a)(3) of the Internal Revenue Code (Code). An organization described in section 501(c)(3) is classified as either a private foundation or a public charity. To be classified as a public charity, an organization must be described in section 509(a)(1), (2), or (3). Organizations described in section 509(a)(3) are known as “supporting organizations.” Supporting organizations achieve their public charity status by providing support to one or more organizations described in section 509(a)(1) or (2), which in this context are referred to as “supported organizations.”

To be described in section 509(a)(3), an organization must satisfy (1) an organizational test, (2) an operational test, (3) a relationship test, and (4) a disqualified person control test. The organizational and operational tests require that a supporting organization be organized and at all times thereafter operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more supported organizations. The rela-

tionship test requires a supporting organization to establish one of three types of relationships with one or more supported organizations. A supporting organization that is operated, supervised or controlled by one or more supported organizations is known as a “Type I” supporting organization. The relationship of a Type I supporting organization with its supported organization(s) is comparable to that of a corporate parent-subsidiary relationship. A supporting organization that is supervised or controlled in connection with one or more supported organizations is known as a “Type II” supporting organization. The relationship of a Type II supporting organization with its supported organization(s) involves common supervision or control by the persons supervising or controlling both the supporting organization and the supported organization(s). A supporting organization that is operated in connection with one or more supported organizations is known as a “Type III” supporting organization and is discussed further in the remainder of this preamble. Finally, the disqualified person control test requires that a supporting organization not be controlled directly or indirectly by certain disqualified persons.

These proposed regulations focus primarily on the relationship test for Type III supporting organizations. Specifically, the proposed regulations reflect statutory changes enacted by sections 1241 through 1243 of the Pension Protection Act of 2006, Public Law 109–280 (120 Stat. 780) (2006) (PPA)), which made the following five changes to the requirements an organization must satisfy to qualify as a Type III supporting organization:

(1) Removed the ability of a charitable trust to rely on the special rule under § 1.509(a)–4(i)(2)(iii) of the regulations then in effect;

(2) Directed the Secretary of the Treasury to promulgate regulations under section 509 that establish a new distribution requirement for Type III supporting organizations that are not “functionally integrated” (a non-functionally integrated (NFI) Type III supporting organization) to ensure that a “significant amount” is paid to supported organizations (for this purpose the term “functionally integrated” means a Type III supporting organization that is not required under Treasury regu-

lations to make payments to supported organizations, because the supporting organization engages in activities that relate to performing the functions of, or carrying out the purposes of, its supported organization(s));

(3) Required a Type III supporting organization to provide annually to each of its supported organizations the information required by the Treasury Department and the IRS to ensure that the supporting organization is responsive to the needs or demands of its supported organization(s);

(4) Prohibited a Type III supporting organization from supporting any supported organization not organized in the United States; and

(5) Prohibited a Type I or Type III supporting organization from accepting a gift or contribution from a person who, alone or together with certain related persons, directly or indirectly controls the governing body of a supported organization of the Type I or Type III supporting organization.

These proposed regulations set forth additional rules on the requirements for Type III supporting organizations, including additional requirements to meet the responsiveness test for all Type III supporting organizations; additional rules regarding the qualification of an organization as a functionally integrated Type III supporting organization under § 1.509(a)–4(i)(4), including provisions for supporting organizations that support governmental entities; and additional rules regarding the required annual distributions under § 1.509(a)–4(i)(5) by a NFI Type III supporting organization. The proposed regulations also define the term “control” for purposes of section 509(f)(2), which prohibits a Type I supporting organization or a Type III supporting organization from accepting contributions from persons who control the governing body of its supported organization(s).

2. Prior Rulemaking

On August 2, 2007, the Treasury Department and the IRS published in the **Federal Register** (72 FR 42335) an advanced notice of proposed rulemaking (ANPRM) (REG–155929–06) in response to the PPA. The ANPRM described proposed rules to implement the

changes made by the PPA to the Type III supporting organization requirements and solicited comments regarding those proposed rules.

On September 24, 2009, the Treasury Department and the IRS published in the **Federal Register** (74 FR 48672) a notice of proposed rulemaking (the 2009 NPRM) (REG-155929-06). The 2009 NPRM contained proposed regulations (the 2009 proposed regulations) setting forth the requirements to qualify as a Type III supporting organization under the PPA.

On December 28, 2012, the Treasury Department and the IRS published in the **Federal Register** (77 FR 76382) a Treasury decision (TD 9605) containing final and temporary regulations (the 2012 TD) regarding the requirements to qualify as a Type III supporting organization. Based on the comments received, the 2012 TD made certain changes to the rules proposed in the 2009 NPRM, included in the temporary regulations significant changes to the distribution requirement, and reserved certain topics for further consideration. Also on December 28, 2012, the Treasury Department and the IRS published in the **Federal Register** (77 FR 76426) a notice of proposed rulemaking (the 2012 NPRM) (REG-155929-06) that incorporated the text of the temporary regulations in the 2012 TD by cross-reference. The 2012 TD provided transition relief for Type III supporting organizations in existence on December 28, 2012, that met and continued to meet the test under former § 1.509(a)-4(i)(3)(ii), as in effect prior to December 28, 2012, treating them as functionally integrated until the first day of their second taxable years beginning after December 28, 2012. The preamble to the 2012 TD also identified issues for possible future rulemaking and requested comments. The IRS received three comments on these issues. The comments were considered in developing these proposed regulations and are available for public inspection at www.regulations.gov or upon request. No public hearing was requested.

The Treasury Department and the IRS published Notice 2014-4, 2014-2 I.R.B. 274, to provide additional transition relief for any Type III supporting organization that (1) supports at least one governmental supported organization to which the sup-

porting organization is responsive within the meaning of § 1.509(a)-4(i)(3) and (2) engages in activities for or on behalf of the governmental supported organization that perform the functions of, or carry out the purposes of, the governmental supported organization and that, but for the involvement of the supporting organization, would normally be engaged in by the governmental supported organization itself. Notice 2014-4 provides that such an organization will be treated as a functionally integrated Type III supporting organization until the earlier of the date final regulations are published under § 1.509(a)-4(i)(4)(iv) in the **Federal Register** or the first day of the organization's third taxable year beginning after December 31, 2013.

On December 23, 2015, the Treasury Department and the IRS published in the **Federal Register** (80 FR 79684) a Treasury Decision (TD 9746) containing final regulations (the 2015 TD) regarding the distribution requirement for NFI Type III supporting organizations. The preamble of those regulations provided that supporting organizations supporting a governmental supported organization could continue to rely on Notice 2014-4 until the date of publication of the notice of proposed rulemaking prescribing the new proposed regulations under § 1.509(a)-4(i)(4)(iv). The IRS received three comments in response to Notice 2014-4, which the Treasury Department and the IRS considered in developing these proposed regulations.

Explanation of Provisions and Summary of Comments

This section describes the proposed provisions and addresses comments that the Treasury Department and the IRS received in response to the 2012 TD and Notice 2014-4.

1. Gifts from Controlling Donor – Meaning of Control

Type I and Type III supporting organizations are prohibited from accepting a gift or contribution from a person who, alone or together with certain related persons, directly or indirectly controls the governing body of a supported organization of the Type I or Type III supporting

organization, or from persons related to a person possessing such control. Section 509(f)(2) and § 1.509(a)-4(f)(5). For this purpose, related persons include family members and 35-percent controlled entities within the meaning of section 4958(f). Although the 2012 TD reserved § 1.509(a)-4(f)(5)(ii), "Meaning of control," the preamble to the 2012 TD indicated that the Treasury Department and the IRS intended to issue proposed regulations that would provide such a definition.

These proposed regulations define "control" for this purpose consistently with § 1.509(a)-4(j), which relates to control by disqualified persons for purposes of the disqualified person control test. In general, under the proposed regulations, the governing body of a supported organization is considered "controlled" by a person if that person, alone or by aggregating his or her votes or positions of authority with certain related persons, as described in section 509(f)(2)(B)(ii) and (iii), may require the governing body of the supported organization to perform any act that significantly affects its operations or may prevent the governing body of the supported organization from performing any such act.

2. Type III Supporting Organization Relationship Test

Section 1.509(a)-4(i)(1) provides that for each taxable year, a Type III supporting organization must satisfy (i) a notification requirement, (ii) a responsiveness test, and (iii) an integral part test provided in the regulations. These proposed regulations provide additional rules regarding each of these requirements.

A. Notification Requirement

Section 509(f)(1)(A) provides that an organization shall not be considered a Type III supporting organization unless the organization provides to each supported organization, for each taxable year, such information as the Secretary may require to ensure that the organization is responsive to the needs or demands of the supported organizations.

To satisfy this notification requirement, § 1.509(a)-4(i)(2) requires a Type III sup-

porting organization to provide to each of its supported organizations for each taxable year: (1) A written notice addressed to a principal officer of the supported organization describing the type and amount of all of the support it provided to the supported organization during the supporting organization's preceding taxable year; (2) a copy of the supporting organization's most recently filed Form 990, "Return of Organization Exempt from Income Tax," or other annual information return required to be filed under section 6033; and (3) a copy of the supporting organization's governing documents, including any amendments (unless previously provided and not subsequently amended). For NFI Type III supporting organizations, the description of support in the written notice includes all of the distributions described in § 1.509(a)-4(i)(6) to the supported organization.

The proposed regulations amend § 1.509(a)-4(i)(2) to clarify that a supporting organization must deliver the required documents to each of its supported organizations by the last day of the fifth month of the taxable year after the taxable year in which the supporting organization provided the support it is reporting. This proposed change is intended to reduce confusion, but does not substantively change the due date or the content of the required notification. Date of delivery is determined applying the general principles of section 7502.

B. Responsiveness Test

Section 1.509(a)-4(i)(3)(i) provides that a supporting organization meets the responsiveness test if it is "responsive to the needs or demands of a supported organization." To meet this responsiveness test, an organization must satisfy: (1) A relationship test described in § 1.509(a)-4(i)(3)(ii) under which the officers, directors, or trustees of the organization have a specified relationship with the officers, directors, or trustees (and in some cases the members) of the supported organization; and (2) a significant voice test described in § 1.509(a)-4(i)(3)(iii) under which the officers, directors, or trustees of the supported organization, by reason of this relationship, have a significant voice in the investment policies of the supporting or-

ganization, the timing of grants, the manner of making grants, and the selection of grant recipients by the supporting organization, and in otherwise directing the use of the income or assets of the supporting organization. The preamble to the 2012 TD stated that, in determining the appropriate distribution amount for NFI Type III supporting organizations, the Treasury Department and the IRS considered the required relationship between a supporting organization and its supported organizations, and that the Treasury Department and the IRS intended to issue proposed regulations in the future that would amend the responsiveness test by requiring a Type III supporting organization to be responsive to all of its supported organizations.

In response to this proposal in the preamble to the 2012 TD, one commenter stated that a supporting organization should not be required to be responsive to all of its supported organizations because the resulting administrative burden would effectively limit the total number of organizations a supporting organization could support. The commenter suggested alternatives under which a supporting organization would be responsive to only a subset of its supported organizations that would vary from year to year.

The Treasury Department and the IRS note that the distinguishing characteristic of Type III supporting organizations, and the basis for their public charity classification, is that they are responsive to and significantly involved in the operations of their publicly supported organizations. See § 1.509(a)-4(f)(4). The Treasury Department and the IRS believe that, unless a Type III supporting organization is responsive to each of its supported organizations, the supported organizations cannot exercise the requisite level of oversight of and engagement with the supporting organization. Limiting the responsiveness requirement to fewer than all of the supported organizations may result in the necessary oversight and accountability being present for less than all of a supporting organization's operations. Therefore, the proposed regulations revise § 1.509(a)-4(i)(3)(i) to require a supporting organization to be responsive to the needs and demands of each of its sup-

ported organizations in order to meet the responsiveness test.

To illustrate how concerns about potential administrative burdens may be addressed consistent with the responsiveness test, the proposed regulations include a new example. The proposed example is intended to demonstrate one way in which a Type III supporting organization that supports multiple organizations may satisfy the responsiveness test in a manner that can be cost-effective. The example shows that a supporting organization can, with respect to each of its supported organizations, meet a different subset of the required relationships with the supporting organization's officers, directors, or trustees listed in § 1.509(a)-4(i)(3)(ii). It also shows how a supporting organization can organize and hold regular meetings, provide information, and encourage communication to help ensure that the supported organizations have a significant voice in the operations of the supporting organization.

Another commenter requested additional guidance regarding the ability of trusts to satisfy the significant voice requirement of the responsiveness test. The new Example 3 provides further illustration of how Type III supporting organizations, including charitable trusts, might satisfy the significant voice requirement of the responsiveness test. The Treasury Department and the IRS note that although the examples in the regulations relating to the responsiveness test may involve a Type III supporting organization that is organized as either a corporation or a trust, the applicable law and relevant regulatory provisions, as modified by the proposed regulations, are applicable to all Type III supporting organizations in the same manner, whether organized as a corporation or a trust. The Treasury Department and the IRS anticipate that Type III supporting organizations may be able to demonstrate they satisfy the responsiveness test in a variety of ways, and that the determination will be based on all the facts and circumstances.

As a result of the proposed changes to the responsiveness test, the proposed regulations also include conforming changes to examples and other regulatory provisions.

C. Integral Part Test – Functionally Integrated Type III Supporting Organizations

Section 1.509(a)–4(i)(1) provides that, for each taxable year, a Type III supporting organization must satisfy the integral part test. The integral part test is satisfied under § 1.509(a)–4(i)(1)(iii) by maintaining significant involvement in the operations of one or more supported organizations and providing support on which the supported organizations are dependent. To satisfy this test, a Type III supporting organization must meet the requirements either for a functionally integrated Type III supporting organization or for an NFI Type III supporting organization, as set forth in § 1.509(a)–4(i)(4) or (5), respectively.

A Type III organization is functionally integrated under § 1.509(a)–4(i)(4) if (1) it engages in activities substantially all of which directly further the exempt purposes of one or more supported organizations and otherwise meets the requirements described in paragraph (i)(4)(ii) of that section, (2) it is the parent of each of its supported organizations as described in paragraph (i)(4)(iii) of that section, or (3) it supports a governmental supported organization and otherwise meets the requirements of paragraph (i)(4)(iv) of that section. The direct furtherance test is not addressed by these regulations.

i. Parent of Each Supported Organization

Under the current regulations, a supporting organization is the parent of a supported organization if the supporting organization exercises a substantial degree of direction over the policies, programs, and activities of the supported organization and a majority of the officers, directors, or trustees of the supported organization is appointed or elected, directly or indirectly, by the governing body, members of the governing body, or officers (acting in their official capacities) of the supporting organization. See § 1.509(a)–4(i)(4)(iii). This definition was adopted by the 2012 TD; however, the preamble to the 2012 TD stated that the Treasury Department and the IRS had determined that the definition of parent was

insufficiently specific. It further stated that the Treasury Department and the IRS intended to issue proposed regulations that would provide a new definition of parent.

As noted in the preamble to the 2009 NPRM, the classification of a parent organization as functionally integrated was intended to “apply to supporting organizations that oversee or facilitate the operation of an integrated system, such as hospital systems.” To more fully accomplish this purpose, the proposed regulations amend § 1.509(a)–4(i)(4)(iii) to clarify that in order for a supporting organization to qualify as the parent of each of its supported organizations, the supporting organization and its supported organizations must be part of an integrated system (such as a hospital system), and the supporting organization must engage in activities typical of the parent of an integrated system. Examples of these activities include (but are not limited to) coordinating the activities of the supported organizations and engaging in overall planning, policy development, budgeting, and resource allocation for the supported organizations. The Treasury Department and the IRS request comments on what activities are typical of the parent of an integrated system, and whether additional activities should be explicitly listed as examples.

The proposed regulations retain the requirement that the governing body, members of the governing body, or officers of the supporting organization must appoint or elect a majority of the officers, directors, or trustees of the supported organization. The Treasury Department and the IRS intend, as stated in the 2009 NPRM, the use of the phrase “appointed or elected, directly or indirectly” to mean the supporting organization could qualify as a parent of a second-tier (or lower) subsidiary. Thus, for example, if the directors of supporting organization A appoint a majority of the directors of supported organization B, which in turn appoints a majority of the directors of supported organization C, the directors of supporting organization A will be treated as appointing the majority of the directors of both supported organization B and supported organization C.

The preamble to the 2012 TD stated that the Treasury Department and the IRS

intended that the new definition of parent would specifically address the power to remove and replace officers, directors, or trustees of the supported organization. The Treasury Department and the IRS interpret the existing requirement under § 1.509(a)–4(i)(4)(iii) that the parent organization have the power to appoint or elect a majority of the officers, directors, or trustees of each supported organization to include the requirement that the parent organization also have the power to remove and replace such officers, directors, or trustees, or otherwise have an ongoing power to appoint or elect with reasonable frequency. The Treasury Department and the IRS request comments on whether § 1.509(a)–4(i)(4)(iii) should be amended to provide further clarification on this issue.

ii. Supporting a Governmental Supported Organization

The 2009 NPRM proposed an exception to the general rules for qualifying as a functionally integrated Type III supporting organization if the supporting organization supported only one governmental entity, which was defined as an entity the assets of which are subject to the appropriations process of a federal, state, local, or Indian tribal government. The 2009 NPRM also provided that in order to be considered functionally integrated, a substantial part of the supporting organization’s total activities had to directly further the exempt purpose(s) of its supported organization, and that exempt purposes are not directly furthered by fundraising, grantmaking, or investing and managing non-exempt-use assets. The Treasury Department and IRS received multiple comments regarding this proposal. The 2012 TD stated the Treasury Department and the IRS were continuing to consider the public comments on the 2009 NPRM regarding this governmental entity exception and reserved § 1.509(a)–4(i)(4)(iv) for future guidance on how a Type III supporting organization can qualify as functionally integrated by supporting a governmental entity.

These proposed regulations take the prior comments into consideration and provide rules to qualify as functionally integrated both for new and existing Type

III supporting organizations that support governmental supported organizations. These proposed rules also define the term “governmental supported organization.”

One commenter stated that the definition of a governmental supported organization in the 2009 NPRM was too complicated and difficult to understand and administer. This commenter proposed using the existing definition of a governmental unit in section 170(b)(1)(A)(v) and (c)(1).

The Treasury Department and the IRS agree with the commenter that for simplicity and administrability the term “governmental supported organization” should be defined by using an existing Code definition of a governmental unit. The proposed regulations define a governmental supported organization as a governmental unit described in section 170(c)(1), or an organization described in section 170(c)(2) and (b)(1)(A) (other than in clauses (vii) and (viii)) that is an instrumentality of one or more governmental units described in section 170(c)(1). The Treasury Department and the IRS further note that a governmental unit described in section 170(c)(1) includes all of the agencies, departments, and divisions of the governmental unit, and all such agencies, departments, and divisions will be treated as one governmental supported organization for purposes of § 1.509(a)–4(i)(4)(iv). The Treasury Department and the IRS specifically request comments on the proposed definition of governmental supported organization.

Two commenters said that the 2009 NPRM’s limit of only one governmental supported organization was too strict and instead recommended allowing a supporting organization to qualify for this exception if it supports at least one governmental supported organization, as Notice 2014–4 provides. One commenter noted that the 2009 NPRM’s limit of only one governmental supported organization would adversely affect existing supporting organizations that support an additional supported organization that is not itself a governmental entity, but that has a substantial operational connection with the governmental supported organization. Another commenter said that the test in Notice 2014–4 was not sufficient because it did not cover activities, such as fund-

raising and grant making, that the governmental supported organization could not otherwise perform.

In response to these comments, the Treasury Department and the IRS propose a new test for Type III supporting organizations that support only governmental supported organizations to qualify as functionally integrated. The Treasury Department and the IRS agree it would be appropriate to treat a Type III supporting organization that supports two or more governmental supported organizations as functionally integrated, provided that the governmental supported organizations are themselves connected geographically or operationally, which will help ensure that the supported organizations provide sufficient input to and oversight of the supporting organization. Thus, the proposed regulations provide that a supporting organization that supports more than one governmental supported organization may be considered functionally integrated if all of its governmental supported organizations either: (1) Operate within the same geographic region (defined as a city, county, or metropolitan area); or (2) work in close coordination or collaboration with one another to conduct a service, program, or activity that the supporting organization supports. To satisfy the close cooperation or coordination requirement, the proposed regulations require a supporting organization to maintain on file a letter from each of the governmental supported organizations (or a joint letter from all of them) describing their collaborative or cooperative efforts with respect to the particular service, program, or activity. In addition, the proposed regulations incorporate the 2009 NPRM proposed requirement that a substantial part of the supporting organization’s total activities must directly further the exempt purposes of its governmental supported organization(s). The Treasury Department and the IRS believe that using a substantial part requirement, instead of the substantially all requirement in § 1.509(a)–4(i)(4)(iv)(A), is appropriate when supporting organizations support only governmental supported organizations operating in the same geographic region or working in close collaboration because the input from and oversight by the governmental supported

organizations minimize the potential for abuse.

Two commenters stated that activities such as fundraising, grant-making, and managing non-exempt-use assets should be considered activities that directly further the exempt purposes of a governmental supported organization. The Treasury Department and the IRS note that the integral part test’s definition of “directly further” in § 1.509(a)–4(i)(4)(ii)(C) generally excludes fundraising, making grants, and investing and managing non-exempt-use assets. The Treasury Department and the IRS excluded these items because they determined that a Type III supporting organization should qualify as functionally integrated only if the supporting organization itself conducts activities that perform the functions of or carry out the purposes of the supported organization (as distinguished from providing financial support for the activities carried out by the supported organization). The Treasury Department and the IRS do not believe a different definition of “directly further” should apply to supporting organizations that support governmental supported organizations. Accordingly, the proposed regulations do not adopt this comment. However, under the proposed rules, these types of organizations would be considered functionally integrated if a substantial part, but not substantially all, of their total activities directly further the exempt purposes of their governmental supported organization(s). Accordingly, these proposed regulations allow these organizations to conduct more fundraising and other financial activities, if certain requirements are met, than is permitted under the substantially all test of § 1.509(a)–4(i)(4)(ii).

In response to comments, the proposed regulations also provide a special rule for existing Type III supporting organizations, provided that they support no more than one additional supported organization that is not a governmental supported organization. A Type III supporting organization in existence on or before February 19, 2016 is treated as functionally integrated if: (1) It supports one or more governmental supported organizations and no more than one supported organization that is not a governmental supported organization; (2) it designated each

of its supported organizations as provided in § 1.509(a)–4(d)(4) on or before February 19, 2016; and (3) a substantial part of its total activities directly furthers the exempt purposes of its governmental supported organization(s).

The proposed regulations also further extend the transition relief provided in Notice 2014–4 and extended by the 2015 TD. Under the proposed regulations, a Type III supporting organization in existence on or before February 19, 2016 that continues to meet the requirements of Notice 2014–4 is treated as functionally integrated until the earlier of the first day of the organization’s first taxable year beginning after the date final regulations under § 1.509(a)–4(i)(4)(iv) are published or the first day of the organization’s second taxable year beginning after February 19, 2016.

D. *Integral Part Test – Non-Functionally Integrated Type III Supporting Organizations*

Section 1.509(a)–4(i)(5) generally provides that an NFI Type III supporting organization meets the integral part test if it satisfies the distribution requirement of paragraph (i)(5)(ii) of that section and the attentiveness requirement of paragraph (i)(5)(iii) of that section. Section 1.509(a)–4(i)(5)(ii) provides that, with respect to each taxable year, a supporting organization must distribute to or for the use of one or more supported organizations an amount equaling or exceeding its “distributable amount”. Section 1.509(a)–4(i)(6) provides the amount of a distribution made to a supported organization is the amount of cash or the fair market value of the property distributed.

For clarity and consistency, the proposed regulations revise § 1.509(a)–4(i)(5)(ii) to state that a supporting organization must make distributions as described in § 1.509(a)–4(i)(6) to satisfy the distribution requirement, and revise section 1.509(a)–4(i)(6) to describe in detail what distributions count towards the distribution requirement.

i. Reduction of Distributable Amount for Taxes Subtitle A Imposes

Section 1.509(a)–4(i)(5)(ii)(B) provides that the distributable amount is equal to the greater of 85 percent of an

organization’s adjusted net income for the immediately preceding taxable year (as determined by applying the principles of section 4942(f) and § 53.4942(a)–2(d)) or its minimum asset amount for the immediately preceding taxable year, reduced by the amount of taxes imposed on the supporting organization under subtitle A of the Code during the immediately preceding taxable year. *See* § 1.509(a)–4(i)(5)(ii)(B).

The Treasury Department and the IRS believe that, because the taxes under subtitle A of the Code are imposed on a supporting organization’s unrelated business taxable income (pursuant to section 511) and the activity that produces the unrelated business taxable income does not further the supported organization’s exempt purposes, these taxes should not be treated as an amount distributed to a supported organization. Therefore, the proposed regulations remove the provision in § 1.509(a)–4(i)(5)(ii)(B) that reduces the distributable amount by the amount of taxes subtitle A of the Code imposed on a supporting organization during the immediately preceding taxable year.

ii. Distributions that Count toward Distribution Requirement

As noted above, § 1.509(a)–4(i)(6) provides details on the distributions by a supporting organization that count toward satisfying the distribution requirement imposed in § 1.509(a)–4(i)(5)(ii). The current regulations provide that distributions include but are not limited to: (1) Any amount paid to a supported organization to accomplish the supported organization’s exempt purposes; (2) any amount paid by the supporting organization to perform an activity that directly furthers the exempt purposes of the supported organization within the meaning of § 1.509(a)–4(i)(4)(ii), but only to the extent such amount exceeds any income derived by the supporting organization from the activity; (3) any reasonable and necessary administrative expenses paid to accomplish the exempt purposes of the supported organization(s), which do not include expenses incurred in the production of investment income; (4) any amount paid to acquire an exempt-use as-

set described in § 1.509(a)–4(i)(8)(ii); and (5) any amount set aside for a specific project that accomplishes the exempt purposes of a supported organization to which the supporting organization is responsive.

The preamble to the 2012 TD stated that the list in § 1.509(a)–4(i)(6) is not exhaustive and other distributions may count toward the distribution requirement. The preamble further stated the Treasury Department and the IRS intended to propose regulations that more fully describe the expenditures (including expenditures for administrative and additional charitable activities) that do and do not count toward the distribution requirement.

The Treasury Department and the IRS believe that the non-exclusive list in the current regulations creates uncertainty for supporting organizations and the IRS about what counts toward the distribution requirement. Therefore, the proposed regulations revise and clarify the list in § 1.509(a)–4(i)(6) of what counts toward the distribution requirement and make it an exclusive list.

The 2012 TD clarified that reasonable and necessary administrative expenses paid to accomplish the exempt purposes of supported organizations, and not expenses incurred in the production of investment income, count toward the distribution requirement. For example, if a supporting organization conducts exempt activities that are for the benefit of, perform the functions of, or carry out the purposes of its supported organization(s) and also conducts nonexempt activities (such as investment activities or unrelated business activities), then the supporting organization’s administrative expenses (such as salaries, rent, utilities and other overhead expenses) must be allocated between the exempt and nonexempt activities on a reasonable and consistently-applied basis. The administrative expenses attributable to the exempt activities are treated as distributions to its supported organization(s) if such expenses are reasonable and necessary. The administrative expenses and operating costs attributable to the nonexempt activities are not treated as distributions to the supported organization(s). The proposed regulations retain this provision, but also provide additional guidance on fundraising expenses.

The 2012 TD did not specifically address whether fundraising expenses count toward the distribution requirement. The proposed regulations specify that reasonable and necessary administrative expenses paid to accomplish the exempt purposes of a supported organization generally do not include fundraising expenses the supporting organization incurs. However, under the proposed regulations, reasonable and necessary expenses incurred by the supporting organization to solicit contributions that a supported organization receives directly from donors count toward the distribution requirement, but only to the extent that the amount of such expenses does not exceed the amount of contributions actually received by the supported organization as a result of the solicitation activities of the supporting organization. The Treasury Department and the IRS believe this rule would provide greater consistency with the treatment of contributions that supporting organizations receive directly and then distribute to their supported organizations (net of the supporting organizations' solicitation expenses). To ensure that a supporting organization has the information it needs to calculate the allowable expenses, the proposed regulations require the supporting organization to obtain written substantiation from the supported organization of the amount of contributions the supported organization actually received as a result of the supporting organization's solicitations.

One commenter requested that program related investments (PRIs) count toward the distribution requirement. The preamble to the 2012 TD stated the 2012 final and temporary regulations did not specifically address whether or not PRIs may count toward the distribution requirement or are excluded in calculating a supporting organization's distributable amount for a taxable year. The Treasury Department and the IRS recognize that private foundations may use PRIs in a variety of ways to accomplish their exempt purposes and that PRIs thus are treated as qualifying distributions under section 4942. However, because supporting organizations must be operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of their supported organizations, they dif-

fer from private foundations. For purposes of meeting the integral part test, the Treasury Department and the IRS do not believe that PRIs should be treated as distributions to supported organizations. The Treasury Department and the IRS believe that other provisions relating to the distribution requirement, such as the availability of set asides and the potential for carry-forwards of excess distributions, provide significant flexibility for supporting organizations to meet the current and future needs of their supported organizations. For these reasons, the proposed regulations do not adopt this comment.

Effective Date and Reliance

These regulations are proposed to be effective on the date the Treasury decision adopting these rules as final or temporary regulations is published in the **Federal Register**. However, taxpayers may rely on the provisions of the proposed regulations until final or temporary regulations are issued.

Statement of Availability of IRS Documents

The IRS Notice 2014-4 cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS Web site at <http://www.irs.gov>.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

In connection with the requirements of the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the collection of information contained in the proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the proposed regulations will not impact a substantial number of small entities.

Based on IRS Statistics of Income data for 2013, there are 1,052,495 active non-profit charitable organizations recognized by the IRS under section 501(c)(3), of which only 7,872 organizations self-identified as Type III supporting organizations. The universe of organizations that would be affected by the collection of information under proposed § 1.509(a)-4(i)(4)(iii) and § 1.509(a)-4(i)(6)(iii) is a subset of all Type III supporting organizations. Thus, the number of organizations that would be affected by the collection of information under proposed § 1.509(a)-4(i)(4)(iii) and (i)(6)(iii), which is expected to be significantly less than 7,872, would not be substantial. Moreover, the time to complete the recordkeeping requirements is expected to be no more than 2 hours for each organization, which would not have a significant economic impact. Therefore, the collection of information under proposed § 1.509(a)-4(i)(4)(iii) and (i)(6)(iii) would not have a significant economic impact.

Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal authors of these regulations are Jonathan Carter and Mike Re-

pass, Office of Associate Chief Counsel (Tax-Exempt and Government Entities). However, other personnel from the Treasury Department and the IRS participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:
Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.509(a)–4 is amended by:

1. Revising paragraphs (f)(5)(ii), (i)(2)(i) introductory text, (i)(2)(i)(A), (i)(2)(iii), and (i)(3)(i);

2. Adding *Example 3* to paragraph (i)(3)(iv);

3. Revising paragraphs (i)(4)(ii)(A)(I), (i)(4)(ii)(B), (i)(4)(iii) and (iv), (i)(5)(ii)(A) and (B), (i)(5)(iii)(A), *Example 4* of paragraph (i)(5)(iii)(D), the third sentence of paragraph (i)(6) introductory text, and paragraphs (i)(6)(iii) and (v) introductory text and (l).

The revisions and additions read as follows:

§ 1.509(a)–4 Supporting organizations.

* * * * *

(f) * * *

(5) * * *

(ii) *Meaning of control.* For purposes of paragraph (f)(5)(i) of this section, the governing body of a supported organization will be considered *controlled* by a person described in paragraph (f)(5)(i)(A) of this section if that person, alone or by aggregating the person's votes or positions of authority with persons described in paragraph (f)(5)(i)(B) or (C) of this section, may require the governing body of the supported organization to perform any act that significantly affects its operations or may prevent the governing body of the supported organization from performing any such act. The governing body of a supported organization will generally be considered to be controlled directly or

indirectly by one or more persons described in paragraph (f)(5)(i)(A), (B), or (C) of this section if the voting power of such persons is 50 percent or more of the total voting power of such governing body or if one or more of such persons have the right to exercise veto power over the actions of the governing body of the supported organization. However, all pertinent facts and circumstances will be taken into consideration in determining whether one or more persons do in fact directly or indirectly control the governing body of a supported organization.

* * * * *

(i) * * *

(2) * * *(i) *Annual notification.* For each taxable year (the Reporting Year), a Type III supporting organization must provide the following documents to each of its supported organizations:

(A) A written notice addressed to a principal officer of the supported organization describing the type and amount of all of the support (including all of the distributions described in paragraph (i)(6) of this section if applicable) the supporting organization provided to the supported organization during the supporting organization's taxable year immediately preceding the Reporting Year (and during any other taxable year of the supporting organization ending after December 28, 2012, for which such support information has not previously been provided);

* * * * *

(iii) *Due date.* The notification documents required by this paragraph (i)(2) shall be delivered or electronically transmitted by the last day of the fifth calendar month of the Reporting Year.

* * * * *

(3) * * *(i) *General rule.* A supporting organization meets the responsiveness test only if it is responsive to the needs or demands of each of its supported organizations. Except as provided in paragraph (i)(3)(v) of this section, in order to meet this test, a supporting organization must satisfy the requirements of paragraphs (i)(3)(ii) and (iii) of this section with respect to each of its supported organizations.

* * * * *

(iv) * * *

Example 3. Z is described in section 501(c)(3). Z's organizational documents provide that it sup-

ports ten different organizations, each of which is described in section 509(a)(1). One of the directors of S (one of the supported organizations) is a voting member of Z's board of directors and participates in Z's regular board meetings. Officers of Z hold regular face-to-face or telephonic meetings during the year to which officers of all the supported organizations are invited. Z's meetings with the supported organizations may be held jointly or separately. Prior to the meetings, Z makes available to the supported organizations (including by email) up-to-date information about its activities including its assets and liabilities, receipts and distributions, and investment policies and returns. In the meetings, officers of each of the supported organizations have an opportunity to ask questions and discuss with officers of Z the projected needs of their organizations, as well as Z's investment and grant making policies and practices. In addition to holding these meetings with the supported organizations, Z provides the contact information of one of its officers to each of the supported organizations and encourages them to contact that officer if they have questions, or if they wish to schedule additional meetings to discuss the projected needs of their organization and how Z should distribute its income and invest its assets. Z provides the information required under paragraph (i)(2) of this section and a copy of its annual audited financial statements to the principal officers of the supported organizations. Z meets the relationship test of paragraph (i)(3)(ii)(B) or (C) of this section with respect to each of its supported organizations. Based on these facts, Z also satisfies the significant voice requirement of paragraph (i)(3)(iii) of this section, and therefore meets the responsiveness test of this paragraph (i)(3) with respect to each of its ten supported organizations.

* * * * *

(4) * * *

(ii) * * *

(A) * * *

(I) Directly further the exempt purposes of one or more supported organizations by performing the functions of, or carrying out the purposes of, such supported organization(s); and

* * * * *

(B) *Meaning of substantially all.* For purposes of paragraph (i)(4)(ii)(A) of this section, in determining whether substantially all of a supporting organization's activities directly further the exempt purposes of one or more supported organization(s), all pertinent facts and circumstances will be taken into consideration.

* * * * *

(iii) *Parent of supported organization(s).* For purposes of paragraph (i)(4)(i)(B) of this section, in order for a supporting organization to qualify as the parent of each of its supported organizations, the supporting organization and its supported organizations must be part of an

integrated system (such as a hospital system), the supporting organization must engage in activities typical of the parent of an integrated system, and a majority of the officers, directors, or trustees of each supported organization must be appointed or elected, directly or indirectly, by the governing body, members of the governing body, or officers (acting in their official capacities) of the supporting organization. For purposes of this paragraph (i)(4)(iii), examples of activities typical of the parent of an integrated system of supported organizations include (but are not limited to) coordinating the activities of the supported organizations and engaging in overall planning, policy development, budgeting, and resource allocation for the supported organizations.

(iv) *Supporting a governmental supported organization*—(A) *In general.* A supporting organization satisfies the requirements of this paragraph (i)(4)(iv) if—

(I) The supporting organization supports only governmental supported organizations, and, if the supporting organization supports more than one governmental supported organization, all of the governmental supported organizations either—

(i) Operate within the same geographic region; or

(ii) Work in close coordination or collaboration with one another to conduct a service, program, or activity that the supporting organization supports; and

(2) A substantial part of the supporting organization's total activities are activities that directly further, as defined by paragraph (i)(4)(ii)(C) of this section, the exempt purposes of its governmental supported organization(s).

(B) *Governmental supported organization defined.* For purposes of paragraph (i)(4)(iv)(A) of this section, the term *governmental supported organization* means a supported organization that is—

(I) A governmental unit described in section 170(c)(1); or

(2) An organization described in section 170(c)(2) and (b)(1)(A) (other than in clauses (vii) and (viii)) that is an instrumentality of one or more governmental units described in section 170(c)(1).

(C) *Geographic region defined.* For purposes of paragraph (i)(4)(iv)(A)(I) of this section, the term *geographic region* means a city, county, or metropolitan area.

(D) *Close cooperation or coordination.* To satisfy the close cooperation or coordination requirement of paragraph (i)(4)(iv)(A)(I) of this section, the supporting organization shall maintain on file a letter from each of the governmental supported organizations (or a joint letter from all of them) describing their collaborative or cooperative efforts with respect to the particular service, program, or activity.

(E) *Exception for organizations supporting a governmental supported organization on or before February 19, 2016.* A Type III supporting organization in existence on or before February 19, 2016 will be treated as meeting the requirements of this paragraph (i)(4)(iv) if it met and continues to meet the following requirements—

(I) It supports one or more governmental supported organizations described in paragraph (i)(4)(iv)(B) of this section and does not support more than one supported organization that is not a governmental supported organization;

(2) Each of the supported organizations is designated by the supporting organization as provided in paragraph (d)(4) of this section on or before February 19, 2016; and

(3) A substantial part of the supporting organization's total activities are activities that directly further, as defined by paragraph (i)(4)(ii)(C) of this section, the exempt purposes of its governmental supported organization(s).

(F) *Transition rule for supporting organizations in existence on or before February 19, 2016.* Until the earlier of the first day of the organization's first taxable year beginning after the date final regulations are published in the **Federal Register** under this paragraph (i)(4)(iv) or the first day of the organization's second taxable year beginning after February 19, 2016, a Type III supporting organization in existence on or before February 19, 2016 will be treated as meeting the requirements of this paragraph (i)(4)(iv) if it met and continues to meet the following requirements—

(I) It supports at least one supported organization that is a governmental entity to which the supporting organization is responsive within the meaning of paragraph (i)(3) of this section; and

(2) It engages in activities for or on behalf of the governmental supported organization described in paragraph (i)(4)(iv)(F)(I) of this section that perform the functions of, or carry out the purposes of, that governmental supported organization and that, but for the involvement of the supporting organization, would normally be engaged in by the governmental supported organization itself.

* * * * *

(5) * * *

(ii) * * *(A) *Annual distribution.* With respect to each taxable year, a supporting organization must make distributions described in paragraph (i)(6) of this section in a total amount equaling or exceeding the supporting organization's distributable amount for the taxable year, as defined in paragraph (i)(5)(ii)(B) of this section, on or before the last day of the taxable year.

(B) *Distributable amount.* Except as provided in paragraphs (i)(5)(ii)(D) and (E) of this section, the distributable amount for a taxable year is an amount equal to the greater of 85 percent of the supporting organization's adjusted net income (as determined by applying the principles of section 4942(f) and § 53.4942(a)–2(d) of this chapter) for the taxable year immediately preceding the taxable year of the required distribution (immediately preceding taxable year) or its minimum asset amount (as defined in paragraph (i)(5)(ii)(C) of this section) for the immediately preceding taxable year.

* * * * *

(iii) * * *(A) *General rule.* With respect to each taxable year, a non-functionally integrated Type III supporting organization must distribute one-third or more of its distributable amount to one or more supported organizations that are attentive to the operations of the supporting organization (within the meaning of paragraph (i)(5)(iii)(B) of this section).

* * * * *

(D) * * *

Example 4. O is an organization described in section 501(c)(3). O is organized to support five private universities, V, W, X, Y, and Z, each of which is described in section 509(a)(1). O meets the responsiveness test described in paragraph (i)(3) of this section with respect to each of its supported organizations. Each year, O distributes an aggregate amount that equals its distributable amount described in paragraph (i)(5)(ii)(B) of this section and distributes an equal amount to each of the five universities. O distributes annually to each of V and W an amount that equals

more than 10 percent of each university's total annual support received in its most recently completed taxable year. Based on these facts, O meets the requirements of paragraph (i)(5)(iii) of this section because it distributes two-fifths (more than the required one-third) of its distributable amount to supported organizations that are attentive to O.

(6) *Distributions that count toward distribution requirement.* * * * Distributions by the supporting organization that count toward the distribution requirement imposed in paragraph (i)(5)(ii) of this section are limited to the following—

* * * * *

(iii) Any reasonable and necessary—

(A) Administrative expenses paid to accomplish the exempt purposes of the supported organization, which do not include expenses incurred in the production of investment income or the conduct of fundraising activities, except as provided in paragraph (i)(6)(iii)(B) of this section; and

(B) Expenses incurred to solicit contributions that are received directly by a supported organization, but only to the extent the amount of such expenses does not exceed the amount of contributions actually received by the supported organization as a result of the solicitation, as substantiated in writing by the supported organization;

* * * * *

(v) Any amount set aside for a specific project that accomplishes the exempt purposes of a supported organization, with such set-aside counting toward the distribution requirement for the taxable year in which the amount is set aside but not in the year in which it is actually paid, if at the time of the set-aside, the supporting organization—

* * * * *

(l) *Effective/applicability dates.* (1) Paragraphs (a)(6), (f)(5), and (i) of this section are effective on December 28, 2012, except—

(i) Paragraphs (i)(4)(ii)(C), (i)(5)(ii)(C) and (D), (i)(6)(iv), (i)(7)(ii), and (i)(8) of this section are applicable on December 21, 2015; and

(ii) Paragraphs (f)(5)(ii), (i)(2)(i) and (iii), (i)(3)(i), (i)(4)(ii)(A)(1), (i)(4)(ii)(B), (i)(4)(iii) and (iv), (i)(5)(ii)(A) and (B), (i)(5)(iii)(A), (i)(6)(i), (iii) and (v) of this section, *Example 3* of paragraph (i)(3)(iv) of this section, and *Example 4* of paragraph (i)(5)(iii)(D) of this section are effective on the date the Treasury decision

adopting these rules as final or temporary regulations is published in the **Federal Register**.

(2) See paragraphs (i)(5)(ii)(B) and (C) and (i)(8) of § 1.509(a)–4T contained in 26 CFR part 1, revised as of April 1, 2015, for certain rules regarding non-functionally integrated Type III supporting organizations effective before December 21, 2015. See paragraphs (i)(5)(ii)(A) and (B) and (i)(5)(iii)(D) of § 1.509(a)–4 (as effective December 21, 2015), for certain rules regarding non-functionally integrated Type III supporting organizations effective before the date the Treasury decision adopting these rules as final or temporary regulations is published in the Federal Register.

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

(Filed by the Office of the Federal Register on February 18, 2016, 8:45 a.m., and published in the issue of the Federal Register for February 19, 2016, 81 F.R. 8446)

Definition of Political Subdivision

REG-129067-15

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance regarding the definition of political subdivision for purposes of tax-exempt bonds. The proposed regulations are necessary to specify the elements of a political subdivision. The proposed regulations will affect State and local governments that issue tax-exempt bonds and users of property financed with tax-exempt bonds. Under certain transition rules, however, the proposed definition of political subdivision will not apply for determining whether outstanding bonds are obligations of a political subdivision and will not apply to existing entities for a transition period. This document also provides a notice of a public hearing for these proposed regulations.

DATES: Written or electronic comments must be received by May 23, 2016. Re-

quest to speak and outlines of topics to be discussed at the public hearing scheduled for June 6, 2016, at 10:00 a.m., must be received by May 23, 2016.

ADDRESSES: Send submissions to: CC: PA:LPD:PR (REG-129067-15), Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC: PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-129067-15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at www.regulations.gov (REG-129067-15). The public hearing will be held at the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION

CONTACT: Concerning the proposed regulations, Spence Hanemann at (202) 317-6980; concerning submissions of comments and the hearing, Oluwafunmilayo (Funmi) Taylor at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under section 103 of the Internal Revenue Code (Code). Section 103 generally provides that, with certain exceptions, gross income does not include interest on any obligation of a State or political subdivision thereof. Section 1.103-1 of the Income Tax Regulations (the Existing Regulations) defines political subdivision as “any division of any State or local governmental unit which is a municipal corporation or which has been delegated the right to exercise part of the sovereign power of the unit.”

On a few occasions, Federal courts have ruled on whether an entity qualifies as a political subdivision. *E.g.*, *Philadelphia Nat'l Bank v. United States*, 666 F.2d 834 (3d Cir. 1981); *Comm'r of Internal Revenue v. White's Estate*, 144 F.2d 1019 (2d Cir. 1944). The IRS has also addressed this issue in revenue rulings, most recently in 1983. *E.g.*, Rev. Rul. 83-131 (1983-2 CB 184); Rev. Rul. 78-138

(1978–1 CB 314). Because the results in these revenue rulings generally turn on the unique facts and circumstances of the individual cases, numerous entities have sought and received letter rulings on whether they are political subdivisions. Letter rulings, however, are limited to their particular facts, may not be relied upon by taxpayers other than the taxpayer that received the ruling, and are not a substitute for published guidance. *See* 26 U.S.C. 6110(k)(3) (2015) (providing generally that a ruling, determination letter, or technical advice memorandum may not be used or cited as precedent).

Commenters have requested additional published guidance, to be applied prospectively, on which facts and circumstances are germane to an entity’s status as a political subdivision. The Treasury Department and IRS recognize the need to clarify the definition of political subdivision to provide greater certainty to prospective issuers and to promote greater consistency in how the definition is applied across a wide range of factual situations. These proposed regulations (the Proposed Regulations) would provide a new definition of political subdivision for purposes of tax-exempt bonds and would update and streamline other portions of the Existing Regulations. The definition of political subdivision in the Proposed Regulations does not apply in determining whether an entity is treated as a political subdivision of a State for purposes of section 414(d) of the Code.

Explanation of Provisions

1. Definition of Political Subdivision

The Proposed Regulations clarify and further develop the eligibility requirements for a political subdivision. To qualify as a political subdivision under the Proposed Regulations, an entity must meet three requirements, taking into account all of the facts and circumstances: sovereign powers, governmental purpose, and governmental control. The Proposed Regulations also authorize the Commissioner to set forth in future guidance to be published in the Internal Revenue Bulletin additional circumstances in which an entity qualifies as a political subdivision.

A. Sovereign powers

The Proposed Regulations continue, without substantive change, the longstanding requirement that a political subdivision be empowered to exercise at least one of the generally recognized sovereign powers. The three sovereign powers recognized for this purpose are eminent domain, police power, and taxing power. *See Comm’r of Internal Revenue v. Shamberg’s Estate*, 144 F.2d 998 (2d Cir. 1944). The entity must be able to exercise a substantial amount of at least one of these powers. *See, e.g.*, Rev. Rul. 77–164 (1977–1 CB 20); Rev. Rul. 77–165 (1977–1 CB 21).

B. Governmental purpose

In determining whether an entity is a political subdivision, the case law and administrative guidance interpreting the definition of political subdivision in the Existing Regulations commonly consider whether the entity serves a public purpose. Historically, the determination of whether an entity serves a public purpose has focused on the purpose for which the entity was created, usually as set forth in the legislation authorizing creation of the entity, rather than on the entity’s conduct after its creation. *See, e.g., Shamberg’s Estate*, 144 F.2d at 1004. The Proposed Regulations require that a political subdivision serve a governmental purpose. A governmental purpose requires, among other things, that the purpose for which the entity was created, as set out in its enabling legislation, be a public purpose and that the entity actually serve that purpose. It also requires that the entity operate in a manner that provides a significant public benefit with no more than incidental benefit to private persons. *Cf.*, Rev. Rul. 90–74 (1990–2 CB 34) (applying an “incidental private benefit” standard for purposes of determining whether income is included in gross income under section 115(1)).

C. Governmental control

The Proposed Regulations provide that a political subdivision must be governmentally controlled. The Proposed Regulations provide rules for determining both what constitutes control and which parties must possess that control.

i. Definition of Control

The Proposed Regulations define control to mean ongoing rights or powers to direct significant actions of the entity. Rights or powers to direct the entity’s actions only at a particular point in time are not ongoing and, therefore, do not constitute control. For example, the right to approve an entity’s plan of operation as a condition of the entity’s formation is not an ongoing right. To constitute control, a collection of rights and powers must enable its holder to direct the significant actions of the entity.

The Proposed Regulations provide three non-exclusive benchmarks of rights or powers that constitute control: (1) the right or power both to approve and to remove a majority of an entity’s governing body; (2) the right or power to elect a majority of the governing body of the entity in periodic elections of reasonable frequency; or (3) the right or power to approve or direct the significant uses of funds or assets of the entity in advance of that use. Aside from these three arrangements, the determination of whether a collection of rights and powers constitutes control will depend on the facts and circumstances. Neither the right to dissolve an entity nor procedures designed to ensure the integrity of the entity but not to direct significant actions of the entity are control. *Cf.*, Rev. Rul. 69–453 (1969–2 CB 182) (addressing procedures that do not constitute control in the context of instrumentalities).

ii. Control Vested in a State or Local Governmental Unit or an Electorate

Control by a small faction of private individuals, business corporations, trusts, partnerships, or other persons is fundamentally not governmental control. Therefore, the Proposed Regulations generally require that control be vested in either a general purpose State or local governmental unit or in an electorate established under an applicable State or local law of general application. If, however, a small faction of private persons controls an electorate, that electorate’s control of the entity does not constitute governmental control of the entity. Accordingly, the Proposed Regulations provide that an entity controlled by an electorate is not governmentally controlled when

the outcome of the exercise of control is determined solely by the votes of an unreasonably small number of private persons.

The determination of whether the number of private persons controlling an electorate is unreasonably small generally depends on all of the facts and circumstances. To provide certainty, the Proposed Regulations limit application of this facts and circumstances test to situations that fall between two quantitative measures of concentration in voting power. The number of private persons controlling an electorate is always unreasonably small if the combined votes of the three voters with the largest shares of votes in the electorate will determine the outcome of the relevant election, regardless of how the other voters vote. The number of private persons controlling an electorate is never unreasonably small if determining the outcome of the relevant election requires the combined votes of more voters than the 10 voters with the largest shares of votes in the electorate. For example, control can always be vested in any electorate comprised of 20 or more voters that each have the right to cast one vote in the relevant election without giving rise to a private faction. For purposes of applying these measures of concentration in voting power, related parties are treated as a single voter and the votes of the related parties are aggregated.

iii. *Possible Relief for Development Districts*

Some observers have suggested that, despite private control, development districts should be political subdivisions during an initial development period in which one or two private developers elect the district's governing body and no other governmental control exists. The Treasury Department and IRS recognize that the governmental control requirement may present challenges for such development districts. In these circumstances, the Treasury Department and IRS are concerned about the potential for excessive private control by individual developers, the attendant impact of excessive issuance of tax-exempt bonds, and inappropriate private benefits from this Federal subsidy. The Treasury Department and IRS seek public comment on whether it is necessary or appropriate to permit such districts to be political subdivisions during an initial

development period; how such relief might be structured; what specific safeguards might be included in the recommended relief to protect against potential abuse; and whether the proposed prospective effective dates and transition periods in § 1.103-1(d) of the Proposed Regulations provide sufficient relief.

2. *Streamlining Amendments*

In addition to amending the definition of political subdivision, paragraphs (a) and (b) of the Proposed Regulations update the references in the general provisions of the Existing Regulations to reflect changes to the Code made in the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085, and other laws and regulations since the promulgation of the long-standing Existing Regulations. The Proposed Regulations also streamline these provisions. In general, the Treasury Department and the IRS intend that these proposed amendments not change the meaning of the Existing Regulations. The last sentence of § 1.103-1(a) of the Proposed Regulations, however, clarifies that the continued tax-exemption of an issue of bonds depends on its issuer's continued status as a qualifying issuer of tax-exempt bonds. The Treasury Department and IRS seek comments on the need for remedial action provisions in the event the entity ceases to qualify as a political subdivision and on the substance of any such provisions.

3. *Applicability Dates and Reliance on Proposed Regulations*

Subject to certain transition rules, the Proposed Regulations generally would apply to all entities for all purposes of the tax-exempt bond provisions of sections 103 and 141 to 150 beginning 90 days after the Proposed Regulations are finalized. In order to ease hardship that may arise from the new definition of political subdivision, under proposed transition rules, that definition would not apply for purposes of determining whether outstanding bonds and refunding bonds in which the weighted average maturity is not extended continue to be obligations of a political subdivision. While these transition rules for outstanding bonds and refunding bonds would apply for the purpose of determining whether these bonds

continue to be obligations of a political subdivision, the new proposed definition of political subdivision would apply for other purposes under sections 103 and 141 to 150, such as whether a new entity that subsequently became a user of a project financed with such bonds qualified as a State or local governmental unit for purposes of section 141. Furthermore, under another proposed transition rule that would apply to entities in existence prior to 30 days after the Proposed Regulations are published, the proposed definition of political subdivision would not apply for any purpose until three years and ninety days after the Proposed Regulations are finalized. This three-year transition period provides existing entities an opportunity to restructure as necessary to satisfy the new definition of political subdivision and allows existing entities to continue to issue new bonds during the transition period. To enhance certainty, an issuer also may choose to apply the definition of political subdivision in § 1.103-1(c) in the final regulations in circumstances in which that definition otherwise would not apply under the transition rules.

In addition, prior to the applicability date of the final regulations, issuers may elect to apply the definition of political subdivision in § 1.103-1(c) of the Proposed Regulations in whole, but not in part, for any purpose of sections 103 and 141 through 150, provided such use is applied consistently for all purposes of sections 103 and 141 through 150 to any given entity.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities.

Comments and Public Hearing

Before these Proposed Regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing has been scheduled for June 6, 2016, at 10:00 a.m., in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic by May 23, 2016. Submit a signed paper or electronic copy of the outline as prescribed in this preamble under the “Addresses” heading. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Spence Hanemann and Timothy Jones, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

Availability of IRS Documents

IRS revenue rulings cited in this notice of proposed rulemaking are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.103–1 is revised to read as follows:

§ 1.103–1 Interest on State or local bonds.

(a) *Interest on State or local bonds.* Under section 103(a), except as otherwise provided in section 103(b), gross income does not include interest on any State or local bond. Under section 103(c), the term *State or local bond* means any obligation (as defined in § 1.150–1(b)) of a State (including for this purpose the District of Columbia or any possession of the United States) or a political subdivision thereof (a State or local governmental unit). Obligations issued by or on behalf of any State or local governmental unit by a constituted authority empowered to issue such obligations are the obligations of such a unit. An obligation qualifies as a State or local bond so long as the issuer of that obligation remains a State or local governmental unit or a constituted authority.

(b) *Certain limitations on interest exclusion.* Under section 103(b), the interest exclusion in section 103(a) is inapplicable to a private activity bond under section 141(a) (unless the bond is a qualified bond under section 141(e)), an arbitrage bond under section 148, or a bond which does not meet the applicable requirements of section 149.

(c) *Definition of political subdivision—*

(1) *In general.* The term *political subdivision* means an entity that meets each of the requirements of paragraphs (c)(2)

(sovereign powers), (c)(3) (governmental purpose), and (c)(4) (governmental control) of this section, taking into account all of the facts and circumstances, or that is described in published guidance issued pursuant to paragraph (c)(5) of this section. Entities that may qualify as political subdivisions include, among others, general purpose governmental entities, such as cities and counties (whether or not incorporated as municipal corporations), and special purpose governmental entities, such as special assessment districts that provide for roads, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvements, and other governmental purposes for a State or local governmental unit.

(2) *Sovereign powers.* Pursuant to a State or local law of general application, the entity has a delegated right to exercise a substantial amount of at least one of the following recognized sovereign powers of a State or local governmental unit: the power of taxation, the power of eminent domain, and police power.

(3) *Governmental purpose.* The entity serves a governmental purpose. The determination of whether an entity serves a governmental purpose is based on, among other things, whether the entity carries out the public purposes that are set forth in the entity’s enabling legislation and whether the entity operates in a manner that provides a significant public benefit with no more than incidental private benefit.

(4) *Governmental control.* A State or local governmental unit exercises control over the entity. For this purpose, control is defined in paragraph (c)(4)(i) of this section and a State or local governmental unit exercises such control only if the control is vested in persons described in paragraph (c)(4)(ii) of this section.

(i) *Definition of control.* *Control* means an ongoing right or power to direct significant actions of the entity. Rights or powers may establish control either individually or in the aggregate. Among rights or powers that may establish control, an ongoing ability to exercise one or more of the following significant rights or powers, on a discretionary and non-ministerial basis, constitutes control: the right or power both to approve and to remove a majority of the governing body of the entity; the right or power to elect a majority of the governing body of the

entity in periodic elections of reasonable frequency; or the right or power to approve or direct the significant uses of funds or assets of the entity in advance of that use. Procedures designed to ensure the integrity of the entity but not to direct significant actions of the entity are insufficient to constitute control of an entity. Examples of such procedures include requirements for submission of audited financial statements of the entity to a higher level State or local governmental unit, open meeting requirements, and conflicts of interest limitations.

(ii) *Control vested in a State or local governmental unit or an electorate.* Control is vested in persons described in paragraphs (c)(4)(ii)(A) or (c)(4)(ii)(B) of this section or a combination thereof:

(A) A State or local governmental unit possessing a substantial amount of each of the sovereign powers and acting through its governing body or through its duly authorized elected or appointed officials in their official capacities; or

(B) An electorate established under applicable State or local law of general application, provided the electorate is not a private faction (as defined in paragraph (c)(4)(iii) of this section).

(iii) *Definition of private faction—(A) In general.* A private faction is any electorate if the outcome of the exercise of control described in paragraph (c)(4)(i) of this section is determined solely by the votes of an unreasonably small number of private persons. The determination of whether a number of such private persons is unreasonably small depends on all of the facts and circumstances, including, without limitation, the entity's governmental purpose, the number of members in the electorate, the relationships of the members of the electorate to one another, the manner of apportionment of votes within the electorate, and the extent to which the members of the electorate adequately represent the interests of persons reasonably affected by the entity's actions. For purposes of this definition, the special rules in paragraphs (c)(4)(iii)(B) through (D) of this section apply.

(B) *Treatment of certain limited electorates as private factions.* An electorate is a private faction if any three private persons that are members of the electorate possess, in the aggregate, a majority of the

votes necessary to determine the outcome of the relevant exercise of control.

(C) *Safe harbor—voting power dispersed among more than 10 persons.* An electorate is not a private faction if the smallest number of private persons who can combine votes to establish a majority of the votes necessary to determine the outcome of the relevant exercise of control is greater than 10 persons. For example, if an electorate consists of 20 private persons with equal, five-percent shares of the total votes, that electorate is not a private faction because a minimum of 11 members of that electorate is necessary to have a majority of the votes. By contrast, for example, if an electorate consists of 20 private persons with unequal voting shares in which some combination of 10 or fewer members has a majority of the votes, then that electorate does not qualify for the safe harbor from treatment as a private faction under this paragraph (c)(4)(iii)(C).

(D) *Operating rules.* The following rules apply for purposes of determining numbers of voters and voting control in paragraphs (c)(4)(iii)(B) and (C) of this section: (1) Related parties (as defined in § 1.150–1(b)) are treated as a single person; and

(2) In computing the number of votes necessary to determine the outcome of the relevant exercise of control, all voters entitled to vote in an election are assumed to cast all votes to which they are entitled.

(5) *Authority of the Commissioner.* In guidance published in the Internal Revenue Bulletin, the Commissioner may set forth additional circumstances in which an entity qualifies as a political subdivision of a State or local governmental unit. See § 601.601(d)(2)(ii) of this chapter.

(d) *Applicability dates—(1) In general.* Except as otherwise provided in paragraphs (d)(2) through (4) of this section, this section applies to all entities for all purposes of sections 103 and 141 through 150 beginning on the date 90 days after the publication of the Treasury decision adopting these rules as final regulations in the Federal Register.

(2) *Applicability date of the definition of political subdivision for outstanding bonds.* For purposes of determining whether outstanding bonds of an entity are obligations of a political subdivision under

section 103, the definition of political subdivision in paragraph (c) of this section does not apply to that entity with respect to its outstanding bonds that are issued before the general applicability date under paragraph (d)(1) of this section.

(3) *Applicability date of the definition of political subdivision for refunding bonds.* For purposes of determining whether refunding bonds of an entity are obligations of a political subdivision under section 103, the definition of political subdivision in paragraph (c) of this section does not apply to that entity with respect to its refunding bonds that are issued on or after the general applicability date under paragraph (d)(1) of this section to refund bonds with respect to which paragraph (c) of this section otherwise does not apply, provided that the weighted average maturity of the refunding bonds is no longer than the remaining weighted average maturity of the refunded bonds.

(4) *Applicability date of the definition of political subdivision for existing entities.* For existing entities that are created or organized before May 21, 2016, the definition of political subdivision in paragraph (c) of this section does not apply for any purpose of sections 103 and 141 to 150 during the three-year period beginning on the general applicability date under paragraph (d)(1) of this section.

(5) *Elective application of definition of political subdivision.* An issuer may choose to apply the definition of political subdivision in paragraph (c) of this section to an issue of bonds in circumstances in which that section otherwise would not apply to that issue under paragraph (d)(2) or (3) of this section, provided that choice is applied consistently to the issue. An entity may choose to apply the definition of political subdivision in paragraph (c) of this section to an entity in circumstances in which that section otherwise would not apply to that entity under paragraph (d)(4) of this section, provided that choice is applied consistently to the entity.

John Dalrymple
Deputy Commissioner for
Services and Enforcement.

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Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with amplified and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the sub-

stance of a prior ruling, a combination of terms is used. For example, modified and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.

ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.

PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2015–27 through 2015–52 is in Internal Revenue Bulletin 2015–52, dated December 28, 2015.

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The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

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