

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

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

ADMINISTRATIVE

REV. RUL. 2020-28, page 1669.

Interest rates: underpayments and overpayments. The rates for interest determined under Section 6621 of the code for the calendar quarter beginning January 1, 2021, will be 3 percent for overpayments (2 percent in the case of a corporation), 3 percent for underpayments, and 5 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 will be 0.5 percent.

T.D. 9912, page 1688.

These final regulations under sections 36B and 6011 of the Internal Revenue Code (Code) clarify that the reduction of the personal exemption deduction to zero for taxable years beginning after December 31, 2017, and before January 1, 2026, does not affect an individual taxpayer's ability to claim the premium tax credit. These final regulations affect individuals who claim the premium tax credit.

EXEMPT ORGANIZATIONS

T.D. 9933, page 1692.

Certain organizations that are generally exempt from federal income taxes are taxed on income from business activities that are not related to their exempt purpose. The calculation

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of the tax on the unrelated business income depends upon whether the tax-exempt organization has more than one unrelated trade or business. The final regulations provide guidance on how these tax-exempt organizations determine if they have more than one unrelated trade or business, and, if so, how to calculate the amount of taxable income they have from the unrelated business activities. The final regulations also clarify that these regulations, as well as others on this topic, apply to individual retirement accounts.

INCOME TAX

T.D. 9934, page 1729.

This document contains final regulations that coordinate the extraordinary disposition rules issued under Treasury regulation section 1.245A-5(c) and (d) and the disqualified basis rule issued under Treasury regulation section 1.951A-2(c)(5). This document also contains reporting rules under section 6038 to facilitate administration of these rules.

T.D. 9935, page 1746.

These final regulations amend the current like-kind exchange regulations to add a definition of real property to implement statutory changes limiting section 1031 treatment to like-kind exchanges of real property. The final regulations also provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in an otherwise qualifying like-kind exchange of real property.

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.

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Part I

Section 6621.— Determination of Rate of Interest

26 CFR 301.6621-1: Interest rate.

Rev. Rul. 2020-28

Section 6621 of the Internal Revenue Code establishes the interest rates on overpayments and underpayments of tax. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding \$10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting “5 percentage points” for “3 percentage points.” See section 6621(c) and section 301.6621-3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621-3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter. Section 6621(b)(2)(A) provides that the federal short-term rate determined

under section 6621(b)(1) for any month applies during the first calendar quarter beginning after that month. Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during that month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

The federal short-term rate determined in accordance with section 1274(d) during October 2020 is the rate published in Revenue Ruling 2020-22, 2020-45 IRB 963, to take effect beginning November 1, 2020. The federal short-term rate, rounded to the nearest full percent, based on daily compounding determined during the month of October 2020 is 0 percent. Accordingly, an overpayment rate of 3 percent (2 percent in the case of a corporation) and an underpayment rate of 3 percent are established for the calendar quarter beginning January 1, 2021. The overpayment rate for the portion of a corporate overpayment exceeding \$10,000 for the calendar quarter beginning January 1, 2021 is 0.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2021, is 5 percent. These rates apply to amounts bearing interest during that calendar quarter.

Sections 6654(a)(1) and 6655(a)(1) provide that the underpayment rate established under section 6621 applies in determining the addition to tax under sections 6654 and 6655 for failure to pay estimated tax for any taxable year. Thus, the 3 percent rate also applies to estimated tax underpayments for the first calendar quarter beginning January 1, 2021. Pursuant to section 6621(b)(2)(B), in determining the addition to tax under section 6654 for any taxable year for an individual, the federal short-term rate that applies during the third month following the taxable year also applies during the first 15 days of the fourth month following the taxable year. In addition, pursuant to section 6603(d)(4), the rate of interest on section 6603 deposits is 0 percent for the first calendar quarter in 2021.

Interest factors for daily compound interest for annual rates of 0.5 percent are published in Appendix A of this Revenue Ruling. Interest factors for daily compound interest for annual rates of 2 percent, 3 percent and 5 percent are published in Tables 9, 11, and 15 of Rev. Proc. 95-17, 1995-1 C.B. 563, 565, and 569.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Casey R. Conrad of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue ruling, contact Mr. Conrad at (202) 317-6844 (not a toll-free number).

APPENDIX A

365 Day Year

0.5% Compound Rate 184 Days

Days	Factor	Days	Factor	Days	Factor
1	0.000013699	63	0.000863380	125	0.001713784
2	0.000027397	64	0.000877091	126	0.001727506
3	0.000041096	65	0.000890801	127	0.001741228
4	0.000054796	66	0.000904512	128	0.001754951
5	0.000068495	67	0.000918223	129	0.001768673
6	0.000082195	68	0.000931934	130	0.001782396
7	0.000095894	69	0.000945646	131	0.001796119
8	0.000109594	70	0.000959357	132	0.001809843
9	0.000123294	71	0.000973069	133	0.001823566
10	0.000136995	72	0.000986781	134	0.001837290
11	0.000150695	73	0.001000493	135	0.001851013
12	0.000164396	74	0.001014206	136	0.001864737
13	0.000178097	75	0.001027918	137	0.001878462
14	0.000191798	76	0.001041631	138	0.001892186
15	0.000205499	77	0.001055344	139	0.001905910
16	0.000219201	78	0.001069057	140	0.001919635
17	0.000232902	79	0.001082770	141	0.001933360
18	0.000246604	80	0.001096484	142	0.001947085
19	0.000260306	81	0.001110197	143	0.001960811
20	0.000274008	82	0.001123911	144	0.001974536
21	0.000287711	83	0.001137625	145	0.001988262
22	0.000301413	84	0.001151339	146	0.002001988
23	0.000315116	85	0.001165054	147	0.002015714
24	0.000328819	86	0.001178768	148	0.002029440
25	0.000342522	87	0.001192483	149	0.002043166
26	0.000356225	88	0.001206198	150	0.002056893
27	0.000369929	89	0.001219913	151	0.002070620
28	0.000383633	90	0.001233629	152	0.002084347
29	0.000397336	91	0.001247344	153	0.002098074
30	0.000411041	92	0.001261060	154	0.002111801
31	0.000424745	93	0.001274776	155	0.002125529
32	0.000438449	94	0.001288492	156	0.002139257
33	0.000452154	95	0.001302208	157	0.002152985
34	0.000465859	96	0.001315925	158	0.002166713
35	0.000479564	97	0.001329641	159	0.002180441
36	0.000493269	98	0.001343358	160	0.002194169
37	0.000506974	99	0.001357075	161	0.002207898
38	0.000520680	100	0.001370792	162	0.002221627
39	0.000534386	101	0.001384510	163	0.002235356
40	0.000548092	102	0.001398227	164	0.002249085
41	0.000561798	103	0.001411945	165	0.002262815

42	0.000575504	104	0.001425663	166	0.002276544
43	0.000589211	105	0.001439381	167	0.002290274
44	0.000602917	106	0.001453100	168	0.002304004
45	0.000616624	107	0.001466818	169	0.002317734
46	0.000630331	108	0.001480537	170	0.002331465
47	0.000644039	109	0.001494256	171	0.002345195
48	0.000657746	110	0.001507975	172	0.002358926
49	0.000671454	111	0.001521694	173	0.002372657
50	0.000685161	112	0.001535414	174	0.002386388
51	0.000698869	113	0.001549133	175	0.002400120
52	0.000712578	114	0.001562853	176	0.002413851
53	0.000726286	115	0.001576573	177	0.002427583
54	0.000739995	116	0.001590293	178	0.002441315
55	0.000753703	117	0.001604014	179	0.002455047
56	0.000767412	118	0.001617734	180	0.002468779
57	0.000781121	119	0.001631455	181	0.002482511
58	0.000794831	120	0.001645176	182	0.002496244
59	0.000808540	121	0.001658897	183	0.002509977
60	0.000822250	122	0.001672619	184	0.002523710
61	0.000835960	123	0.001686340		
62	0.000849670	124	0.001700062		

366 Day Year
0.5% Compound Rate 184 Days

Days	Factor	Days	Factor	Days	Factor
1	0.000013661	63	0.000861020	125	0.001709097
2	0.000027323	64	0.000874693	126	0.001722782
3	0.000040984	65	0.000888366	127	0.001736467
4	0.000054646	66	0.000902040	128	0.001750152
5	0.000068308	67	0.000915713	129	0.001763837
6	0.000081970	68	0.000929387	130	0.001777522
7	0.000095632	69	0.000943061	131	0.001791208
8	0.000109295	70	0.000956735	132	0.001804893
9	0.000122958	71	0.000970409	133	0.001818579
10	0.000136620	72	0.000984084	134	0.001832265
11	0.000150283	73	0.000997758	135	0.001845951
12	0.000163947	74	0.001011433	136	0.001859638
13	0.000177610	75	0.001025108	137	0.001873324
14	0.000191274	76	0.001038783	138	0.001887011
15	0.000204938	77	0.001052459	139	0.001900698
16	0.000218602	78	0.001066134	140	0.001914385
17	0.000232266	79	0.001079810	141	0.001928073
18	0.000245930	80	0.001093486	142	0.001941760
19	0.000259595	81	0.001107162	143	0.001955448
20	0.000273260	82	0.001120839	144	0.001969136
21	0.000286924	83	0.001134515	145	0.001982824
22	0.000300590	84	0.001148192	146	0.001996512
23	0.000314255	85	0.001161869	147	0.002010201
24	0.000327920	86	0.001175546	148	0.002023889
25	0.000341586	87	0.001189223	149	0.002037578
26	0.000355252	88	0.001202900	150	0.002051267
27	0.000368918	89	0.001216578	151	0.002064957
28	0.000382584	90	0.001230256	152	0.002078646
29	0.000396251	91	0.001243934	153	0.002092336
30	0.000409917	92	0.001257612	154	0.002106025
31	0.000423584	93	0.001271291	155	0.002119715
32	0.000437251	94	0.001284969	156	0.002133405
33	0.000450918	95	0.001298648	157	0.002147096
34	0.000464586	96	0.001312327	158	0.002160786
35	0.000478253	97	0.001326006	159	0.002174477
36	0.000491921	98	0.001339685	160	0.002188168
37	0.000505589	99	0.001353365	161	0.002201859
38	0.000519257	100	0.001367044	162	0.002215550
39	0.000532925	101	0.001380724	163	0.002229242
40	0.000546594	102	0.001394404	164	0.002242933
41	0.000560262	103	0.001408085	165	0.002256625
42	0.000573931	104	0.001421765	166	0.002270317

43	0.000587600	105	0.001435446	167	0.002284010
44	0.000601269	106	0.001449127	168	0.002297702
45	0.000614939	107	0.001462808	169	0.002311395
46	0.000628608	108	0.001476489	170	0.002325087
47	0.000642278	109	0.001490170	171	0.002338780
48	0.000655948	110	0.001503852	172	0.002352473
49	0.000669618	111	0.001517533	173	0.002366167
50	0.000683289	112	0.001531215	174	0.002379860
51	0.000696959	113	0.001544897	175	0.002393554
52	0.000710630	114	0.001558580	176	0.002407248
53	0.000724301	115	0.001572262	177	0.002420942
54	0.000737972	116	0.001585945	178	0.002434636
55	0.000751643	117	0.001599628	179	0.002448331
56	0.000765315	118	0.001613311	180	0.002462025
57	0.000778986	119	0.001626994	181	0.002475720
58	0.000792658	120	0.001640678	182	0.002489415
59	0.000806330	121	0.001654361	183	0.002503110
60	0.000820003	122	0.001668045	184	0.002516806
61	0.000833675	123	0.001681729		
62	0.000847348	124	0.001695413		

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

		PERIOD			RATE		In 1995-1 C.B. DAILY RATE TABLE		
Before		Jul.	1,	1975	6%	Table	2,	pg.	557
Jul.	1,	1975-Jan.	31,	1976	9%	Table	4,	pg.	559
Feb.	1,	1976-Jan.	31,	1978	7%	Table	3,	pg.	558
Feb.	1,	1978-Jan.	31,	1980	6%	Table	2,	pg.	557
Feb.	1,	1980-Jan.	31,	1982	12%	Table	5,	pg.	560
Feb.	1,	1982-Dec.	31,	1982	20%	Table	6,	pg.	560
Jan.	1,	1983-Jun.	30,	1983	16%	Table	37,	pg.	591
Jul.	1,	1983-Dec.	31,	1983	11%	Table	27,	pg.	581
Jan.	1,	1984-Jun.	30,	1984	11%	Table	75,	pg.	629
Jul.	1,	1984-Dec.	31,	1984	11%	Table	75,	pg.	629
Jan.	1,	1985-Jun.	30,	1985	13%	Table	31,	pg.	585
Jul.	1,	1985-Dec.	31,	1985	11%	Table	27,	pg.	581
Jan.	1,	1986-Jun.	30,	1986	10%	Table	25,	pg.	579
Jul.	1,	1986-Dec.	31,	1986	9%	Table	23,	pg.	577

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 - Dec. 31, 1998

					OVERPAYMENTS		UNDERPAYMENTS			
					1995-1 C.B.		1995-1 C.B. RATE			
					RATE	TABLE	PG	RATE	TABLE	PG
Jan.	1,	1987-Mar.	31,	1987	8%	21	575	9%	23	577
Apr.	1,	1987-Jun.	30,	1987	8%	21	575	9%	23	577
Jul.	1,	1987-Sep.	30,	1987	8%	21	575	9%	23	577
Oct.	1,	1987-Dec.	31,	1987	9%	23	577	10%	25	579
Jan.	1,	1988-Mar.	31,	1988	10%	73	627	11%	75	629
Apr.	1,	1988-Jun.	30,	1988	9%	71	625	10%	73	627
Jul.	1,	1988-Sep.	30,	1988	9%	71	625	10%	73	627
Oct.	1,	1988-Dec.	31,	1988	10%	73	627	11%	75	629
Jan.	1,	1989-Mar.	31,	1989	10%	25	579	11%	27	581
Apr.	1,	1989-Jun.	30,	1989	11%	27	581	12%	29	583
Jul.	1,	1989-Sep.	30,	1989	11%	27	581	12%	29	583
Oct.	1,	1989-Dec.	31,	1989	10%	25	579	11%	27	581
Jan.	1,	1990-Mar.	31,	1990	10%	25	579	11%	27	581
Apr.	1,	1990-Jun.	30,	1990	10%	25	579	11%	27	581
Jul.	1,	1990-Sep.	30,	1990	10%	25	579	11%	27	581
Oct.	1,	1990-Dec.	31,	1990	10%	25	579	11%	27	581
Jan.	1,	1991-Mar.	31,	1991	10%	25	579	11%	27	581
Apr.	1,	1991-Jun.	30,	1991	9%	23	577	10%	25	579

Jul.	1,	1991-Sep.	30,	1991	9%	23	577	10%	25	579
Oct.	1,	1991-Dec.	31,	1991	9%	23	577	10%	25	579
Jan.	1,	1992-Mar.	31,	1992	8%	69	623	9%	71	625
Apr.	1,	1992-Jun.	30,	1992	7%	67	621	8%	69	623
Jul.	1,	1992-Sep.	30,	1992	7%	67	621	8%	69	623
Oct.	1,	1992-Dec.	31,	1992	6%	65	619	7%	67	621
Jan.	1,	1993-Mar.	31,	1993	6%	17	571	7%	19	573
Apr.	1,	1993-Jun.	30,	1993	6%	17	571	7%	19	573
Jul.	1,	1993-Sep.	30,	1993	6%	17	571	7%	19	573
Oct.	1,	1993-Dec.	31,	1993	6%	17	571	7%	19	573
Jan.	1,	1994-Mar.	31,	1994	6%	17	571	7%	19	573
Apr.	1,	1994-Jun.	30,	1994	6%	17	571	7%	19	573
Jul.	1,	1994-Sep.	30,	1994	7%	19	573	8%	21	575
Oct.	1,	1994-Dec.	31,	1994	8%	21	575	9%	23	577
Jan.	1,	1995-Mar.	31,	1995	8%	21	575	9%	23	577
Apr.	1,	1995-Jun.	30,	1995	9%	23	577	10%	25	579
Jul.	1,	1995-Sep.	30,	1995	8%	21	575	9%	23	577
Oct.	1,	1995-Dec.	31,	1995	8%	21	575	9%	23	577
Jan.	1,	1996-Mar.	31,	1996	8%	69	623	9%	71	625
Apr.	1,	1996-Jun.	30,	1996	7%	67	621	8%	69	623
Jul.	1,	1996-Sep.	30,	1996	8%	69	623	9%	71	625
Oct.	1,	1996-Dec.	31,	1996	8%	69	623	9%	71	625
Jan.	1,	1997-Mar.	31,	1997	8%	21	575	9%	23	577
Apr.	1,	1997-Jun.	30,	1997	8%	21	575	9%	23	577
Jul.	1,	1997-Sep.	30,	1997	8%	21	575	9%	23	577
Oct.	1,	1997-Dec.	31,	1997	8%	21	575	9%	23	577
Jan.	1,	1998-Mar.	31,	1998	8%	21	575	9%	23	577
Apr.	1,	1998-Jun.	30,	1998	7%	19	573	8%	21	575
Jul.	1,	1998-Sep.	30,	1998	7%	19	573	8%	21	575
Oct.	1,	1998-Dec.	31,	1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

					1995-1 C.B.		
					RATE	TABLE	PAGE
Jan.	1,	1999–Mar.	31,	1999	7%	19	573
Apr.	1,	1999–Jun.	30,	1999	8%	21	575
Jul.	1,	1999–Sep.	30,	1999	8%	21	575
Oct.	1,	1999–Dec.	31,	1999	8%	21	575
Jan.	1,	2000–Mar.	31,	2000	8%	69	623
Apr.	1,	2000–Jun.	30,	2000	9%	71	625
Jul.	1,	2000–Sep.	30,	2000	9%	71	625
Oct.	1,	2000–Dec.	31,	2000	9%	71	625
Jan.	1,	2001–Mar.	31,	2001	9%	23	577
Apr.	1,	2001–Jun.	30,	2001	8%	21	575
Jul.	1,	2001–Sep.	30,	2001	7%	19	573
Oct.	1,	2001–Dec.	31,	2001	7%	19	573
Jan.	1,	2002–Mar.	31,	2002	6%	17	571
Apr.	1,	2002–Jun.	30,	2002	6%	17	571
Jul.	1,	2002–Sep.	30,	2002	6%	17	571
Oct.	1,	2002–Dec.	31,	2002	6%	17	571
Jan.	1,	2003–Mar.	31,	2003	5%	15	569
Apr.	1,	2003–Jun.	30,	2003	5%	15	569
Jul.	1,	2003–Sep.	30,	2003	5%	15	569
Oct.	1,	2003–Dec.	31,	2003	4%	13	567
Jan.	1,	2004–Mar.	31,	2004	4%	61	615
Apr.	1,	2004–Jun.	30,	2004	5%	63	617
Jul.	1,	2004–Sep.	30,	2004	4%	61	615
Oct.	1,	2004–Dec.	31,	2004	5%	63	617
Jan.	1,	2005–Mar.	31,	2005	5%	15	569
Apr.	1,	2005–Jun.	30,	2005	6%	17	571
Jul.	1,	2005–Sep.	30,	2005	6%	17	571
Oct.	1,	2005–Dec.	31,	2005	7%	19	573
Jan.	1,	2006–Mar.	31,	2006	7%	19	573
Apr.	1,	2006–Jun.	30,	2006	7%	19	573
Jul.	1,	2006–Sep.	30,	2006	8%	21	575
Oct.	1,	2006–Dec.	31,	2006	8%	21	575
Jan.	1,	2007–Mar.	31,	2007	8%	21	575
Apr.	1,	2007–Jun.	30,	2007	8%	21	575
Jul.	1,	2007–Sep.	30,	2007	8%	21	575
Oct.	1,	2007–Dec.	31,	2007	8%	21	575
Jan.	1,	2008–Mar.	31,	2008	7%	67	621
Apr.	1,	2008–Jun.	30,	2008	6%	65	619
Jul.	1,	2008–Sep.	30,	2008	5%	63	617
Oct.	1,	2008–Dec.	31,	2008	6%	65	619

Jan.	1,	2009–Mar.	31,	2009	5%	15	569
Apr.	1,	2009–Jun.	30,	2009	4%	13	567
Jul.	1,	2009–Sep.	30,	2009	4%	13	567
Oct.	1,	2009–Dec.	31,	2009	4%	13	567
Jan.	1,	2010–Mar.	31,	2010	4%	13	567
Apr.	1,	2010–Jun.	30,	2010	4%	13	567
Jul.	1,	2010–Sep.	30,	2010	4%	13	567
Oct.	1,	2010–Dec.	31,	2010	4%	13	567
Jan.	1,	2011–Mar.	31,	2011	3%	11	565
Apr.	1,	2011–Jun.	30,	2011	4%	13	567
Jul.	1,	2011–Sep.	30,	2011	4%	13	567
Oct.	1,	2011–Dec.	31,	2011	3%	11	565
Jan.	1,	2012–Mar.	31,	2012	3%	59	613
Apr.	1,	2012–Jun.	30,	2012	3%	59	613
Jul.	1,	2012–Sep.	30,	2012	3%	59	613
Oct.	1,	2012–Dec.	31,	2012	3%	59	613
Jan.	1,	2013–Mar.	31,	2013	3%	11	565
Apr.	1,	2013–Jun.	30,	2013	3%	11	565
Jul.	1,	2013–Sep.	30,	2013	3%	11	565
Oct.	1,	2013–Dec.	31,	2013	3%	11	565
Jan.	1,	2014–Mar.	31,	2014	3%	11	565
Apr.	1,	2014–Jun.	30,	2014	3%	11	565
Jul.	1,	2014–Sep.	30,	2014	3%	11	565
Oct.	1,	2014–Dec.	31,	2014	3%	11	565
Jan.	1,	2015–Mar.	31,	2015	3%	11	565
Apr.	1,	2015–Jun.	30,	2015	3%	11	565
Jul.	1,	2015–Sep.	30,	2015	3%	11	565
Oct.	1,	2015–Dec.	31,	2015	3%	11	565
Jan.	1,	2016–Mar.	31,	2016	3%	59	613
Apr.	1,	2016–Jun.	30,	2016	4%	61	615
Jul.	1,	2016–Sep.	30,	2016	4%	61	615
Oct.	1,	2016–Dec.	31,	2016	4%	61	615
Jan.	1,	2017–Mar.	31,	2017	4%	13	567
Apr.	1,	2017–Jun.	30,	2017	4%	13	567
Jul.	1,	2017–Sep.	30,	2017	4%	13	567
Oct.	1,	2017–Dec.	31,	2017	4%	13	567
Jan.	1,	2018–Mar.	31,	2018	4%	13	567
Apr.	1,	2018–Jun.	30,	2018	5%	15	569
Jul.	1,	2018–Sep.	30,	2018	5%	15	569
Oct.	1,	2018–Dec.	31,	2018	5%	15	569
Jan.	1,	2019–Mar.	31,	2019	6%	17	571
Apr.	1,	2019–Jun.	30,	2019	6%	17	571
Jul.	1,	2019–Sep.	30,	2019	5%	15	569
Oct.	1,	2019–Dec.	31,	2019	5%	15	569

Jan.	1,	2020–Mar.	31,	2020	5%	63	617
Apr.	1,	2020–Jun.	30,	2020	5%	63	617
Jul.	1,	2020–Sep.	30,	2020	3%	59	613
Oct.	1,	2020–Dec.	31,	2020	3%	59	613
Jan.	1,	2021–Mar.	31,	2021	3%	11	565

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

				OVERPAYMENTS			UNDERPAYMENTS			
				1995-1 C.B.			1995-1 C.B.			
				RATE	TABLE	PG	RATE	TABLE	PG	
Jan.	1,	1999–Mar.	31,	1999	6%	17	571	7%	19	573
Apr.	1,	1999–Jun.	30,	1999	7%	19	573	8%	21	575
Jul.	1,	1999–Sep.	30,	1999	7%	19	573	8%	21	575
Oct.	1,	1999–Dec.	31,	1999	7%	19	573	8%	21	575
Jan.	1,	2000–Mar.	31,	2000	7%	67	621	8%	69	623
Apr.	1,	2000–Jun.	30,	2000	8%	69	623	9%	71	625
Jul.	1,	2000–Sep.	30,	2000	8%	69	623	9%	71	625
Oct.	1,	2000–Dec.	31,	2000	8%	69	623	9%	71	625
Jan.	1,	2001–Mar.	31,	2001	8%	21	575	9%	23	577
Apr.	1,	2001–Jun.	30,	2001	7%	19	573	8%	21	575
Jul.	1,	2001–Sep.	30,	2001	6%	17	571	7%	19	573
Oct.	1,	2001–Dec.	31,	2001	6%	17	571	7%	19	573
Jan.	1,	2002–Mar.	31,	2002	5%	15	569	6%	17	571
Apr.	1,	2002–Jun.	30,	2002	5%	15	569	6%	17	571
Jul.	1,	2002–Sep.	30,	2002	5%	15	569	6%	17	571
Oct.	1,	2002–Dec.	31,	2002	5%	15	569	6%	17	571
Jan.	1,	2003–Mar.	31,	2003	4%	13	567	5%	15	569
Apr.	1,	2003–Jun.	30,	2003	4%	13	567	5%	15	569
Jul.	1,	2003–Sep.	30,	2003	4%	13	567	5%	15	569
Oct.	1,	2003–Dec.	31,	2003	3%	11	565	4%	13	567
Jan.	1,	2004–Mar.	31,	2004	3%	59	613	4%	61	615
Apr.	1,	2004–Jun.	30,	2004	4%	61	615	5%	63	617
Jul.	1,	2004–Sep.	30,	2004	3%	59	613	4%	61	615
Oct.	1,	2004–Dec.	31,	2004	4%	61	615	5%	63	617
Jan.	1,	2005–Mar.	31,	2005	4%	13	567	5%	15	569
Apr.	1,	2005–Jun.	30,	2005	5%	15	569	6%	17	571
Jul.	1,	2005–Sep.	30,	2005	5%	15	569	6%	17	571
Oct.	1,	2005–Dec.	31,	2005	6%	17	571	7%	19	573
Jan.	1,	2006–Mar.	31,	2006	6%	17	571	7%	19	573
Apr.	1,	2006–Jun.	30,	2006	6%	17	571	7%	19	573
Jul.	1,	2006–Sep.	30,	2006	7%	19	573	8%	21	575
Oct.	1,	2006–Dec.	31,	2006	7%	19	573	8%	21	575
Jan.	1,	2007–Mar.	31,	2007	7%	19	573	8%	21	575
Apr.	1,	2007–Jun.	30,	2007	7%	19	573	8%	21	575
Jul.	1,	2007–Sep.	30,	2007	7%	19	573	8%	21	575
Oct.	1,	2007–Dec.	31,	2007	7%	19	573	8%	21	575
Jan.	1,	2008–Mar.	31,	2008	6%	65	619	7%	67	621
Apr.	1,	2008–Jun.	30,	2008	5%	63	617	6%	65	619
Jul.	1,	2008–Sep.	30,	2008	4%	61	615	5%	63	617
Oct.	1,	2008–Dec.	31,	2008	5%	63	617	6%	65	619

Jan.	1,	2009–Mar.	31,	2009	4%	13	567	5%	15	569
Apr.	1,	2009–Jun.	30,	2009	3%	11	565	4%	13	567
Jul.	1,	2009–Sep.	30,	2009	3%	11	565	4%	13	567
Oct.	1,	2009–Dec.	31,	2009	3%	11	565	4%	13	567
Jan.	1,	2010–Mar.	31,	2010	3%	11	565	4%	13	567
Apr.	1,	2010–Jun.	30,	2010	3%	11	565	4%	13	567
Jul.	1,	2010–Sep.	30,	2010	3%	11	565	4%	13	567
Oct.	1,	2010–Dec.	31,	2010	3%	11	565	4%	13	567
Jan.	1,	2011–Mar.	31,	2011	2%	9	563	3%	11	565
Apr.	1,	2011–Jun.	30,	2011	3%	11	565	4%	13	567
Jul.	1,	2011–Sep.	30,	2011	3%	11	565	4%	13	567
Oct.	1,	2011–Dec.	31,	2011	2%	9	563	3%	11	565
Jan.	1,	2012–Mar.	31,	2012	2%	57	611	3%	59	613
Apr.	1,	2012–Jun.	30,	2012	2%	57	611	3%	59	613
Jul.	1,	2012–Sep.	30,	2012	2%	57	611	3%	59	613
Oct.	1,	2012–Dec.	31,	2012	2%	57	611	3%	59	613
Jan.	1,	2013–Mar.	31,	2013	2%	9	563	3%	11	565
Apr.	1,	2013–Jun.	30,	2013	2%	9	563	3%	11	565
Jul.	1,	2013–Sep.	30,	2013	2%	9	563	3%	11	565
Oct.	1,	2013–Dec.	31,	2013	2%	9	563	3%	11	565
Jan.	1,	2014–Mar.	31,	2014	2%	9	563	3%	11	565
Apr.	1,	2014–Jun.	30,	2014	2%	9	563	3%	11	565
Jul.	1,	2014–Sep.	30,	2014	2%	9	563	3%	11	565
Oct.	1,	2014–Dec.	31,	2014	2%	9	563	3%	11	565
Jan.	1,	2015–Mar.	31,	2015	2%	9	563	3%	11	565
Apr.	1,	2015–Jun.	30,	2015	2%	9	563	3%	11	565
Jul.	1,z	2015–Sep.	30,	2015	2%	9	563	3%	11	565
Oct.	1,	2015–Dec.	31,	2015	2%	9	563	3%	11	565
Jan.	1,	2016–Mar.	31,	2016	2%	57	611	3%	59	613
Apr.	1,	2016–Jun.	30,	2016	3%	59	613	4%	61	615
Jul.	1,	2016–Sep.	30,	2016	3%	59	613	4%	61	615
Oct.	1,	2016–Dec.	31,	2016	3%	59	613	4%	61	615
Jan.	1,	2017–Mar.	31,	2017	3%	11	565	4%	13	567
Apr.	1,	2017–Jun.	30,	2017	3%	11	565	4%	13	567
Jul.	1,	2017–Sep.	30,	2017	3%	11	565	4%	13	567
Oct.	1,	2017–Dec.	31,,	2017	3%	11	565	4%	13	567
Jan.	1,	2018–Mar.	31,	2018	3%	11	565	4%	13	567
Apr.	1,	2018–Jun.	30,	2018	4%	13	567	5%	15	569
Jul.	1,	2018–Sep.	30,	2018	4%	13	567	5%	15	569
Oct.	1,	2018–Dec.	31,	2018	4%	13	567	5%	15	569
Jan.	1,	2019–Mar.	31,	2019	5%	15	569	6%	17	571
Apr.	1,	2019–Jun.	30,	2019	5%	15	569	6%	17	571
Jul.	1,	2019–Sep.	30,	2019	4%	13	567	5%	15	569
Oct.	1,	2019–Dec.	31,	2019	4%	13	567	5%	15	569
Jan.	1,	2020–Mar.	31,	2020	4%	61	615	5%	63	617

Apr.	1,	2020–Jun.	30,	2020	4%	61	615	5%	63	617
Jul.	1,	2020–Sep.	30,	2020	2%	57	611	3%	59	613
Oct.	1,	2020–Dec.	31,	2020	2%	57	611	3%	59	613
Jan.	1,	2021–Mar.	31,	2021	2%	9	563	3%	11	565

TABLE OF INTEREST RATES
FOR LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 - PRESENT

					1995-1 C.B.		
					RATE	TABLE	PG
Jan.	1,	1991–Mar.	31,	1991	13%	31	585
Apr.	1,	1991–Jun.	30,	1991	12%	29	583
Jul.	1,	1991–Sep.	30,	1991	12%	29	583
Oct.	1,	1991–Dec.	31,	1991	12%	29	583
Jan.	1,	1992–Mar.	31,	1992	11%	75	629
Apr.	1,	1992–Jun.	30,	1992	10%	73	627
Jul.	1,	1992–Sep.	30,	1992	10%	73	627
Oct.	1,	1992–Dec.	31,	1992	9%	71	625
Jan.	1,	1993–Mar.	31,	1993	9%	23	577
Apr.	1,	1993–Jun.	30,	1993	9%	23	577
Jul.	1,	1993–Sep.	30,	1993	9%	23	577
Oct.	1,	1993–Dec.	31,	1993	9%	23	577
Jan.	1,	1994–Mar.	31,	1994	9%	23	577
Apr.	1,	1994–Jun.	30,	1994	9%	23	577
Jul.	1,	1994–Sep.	30,	1994	10%	25	579
Oct.	1,	1994–Dec.	31,	1994	11%	27	581
Jan.	1,	1995–Mar.	31,	1995	11%	27	581
Apr.	1,	1995–Jun.	30,	1995	12%	29	583
Jul.	1,	1995–Sep.	30,	1995	11%	27	581
Oct.	1,	1995–Dec.	31,	1995	11%	27	581
Jan.	1,	1996–Mar.	31,	1996	11%	75	629
Apr.	1,	1996–Jun.	30,	1996	10%	73	627
Jul.	1,	1996–Sep.	30,	1996	11%	75	629
Oct.	1,	1996–Dec.	31,	1996	11%	75	629
Jan.	1,	1997–Mar.	31,	1997	11%	27	581
Apr.	1,	1997–Jun.	30,	1997	11%	27	581
Jul.	1,	1997–Sep.	30,	1997	11%	27	581
Oct.	1,	1997–Dec.	31,	1997	11%	27	581
Jan.	1,	1998–Mar.	31,	1998	11%	27	581
Apr.	1,	1998–Jun.	30,	1998	10%	25	579
Jul.	1,	1998–Sep.	30,	1998	10%	25	579
Oct.	1,	1998–Dec.	31,	1998	10%	25	579
Jan.	1,	1999–Mar.	31,	1999	9%	23	577
Apr.	1,	1999–Jun.	30,	1999	10%	25	579
Jul.	1,	1999–Sep.	30,	1999	10%	25	579
Oct.	1,	1999–Dec.	31,	1999	10%	25	579
Jan.	1,	2000–Mar.	31,	2000	10%	73	627
Apr.	1,	2000–Jun.	30,	2000	11%	75	629
Jul.	1,	2000–Sep.	30,	2000	11%	75	629
Oct.	1,	2000–Dec.	31,	2000	11%	75	629
Jan.	1,	2001–Mar.	31,	2001	11%	27	581

Apr.	1,	2001–Jun.	30,	2001	10%	25	579
Jul.	1,	2001–Sep.	30,	2001	9%	23	577
Oct.	1,	2001–Dec.	31,	2001	9%	23	577
Jan.	1,	2002–Mar.	31,	2002	8%	21	575
Apr.	1,	2002–Jun.	30,	2002	8%	21	575
Jul.	1,	2002–Sep.	30,	2002	8%	21	575
Oct.	1,	2002–Dec.	31,	2002	8%	21	575
Jan.	1,	2003–Mar.	31,	2003	7%	19	573
Apr.	1,	2003–Jun.	30,	2003	7%	19	573
Jul.	1,	2003–Sep.	30,	2003	7%	19	573
Oct.	1,	2003–Dec.	31,	2003	6%	17	571
Jan.	1,	2004–Mar.	31,	2004	6%	65	619
Apr.	1,	2004–Jun.	30,	2004	7%	67	621
Jul.	1,	2004–Sep.	30,	2004	6%	65	619
Oct.	1,	2004–Dec.	31,	2004	7%	67	621
Jan.	1,	2005–Mar.	31,	2005	7%	19	573
Apr.	1,	2005–Jun.	30,	2005	8%	21	575
Jul.	1,	2005–Sep.	30,	2005	8%	21	575
Oct.	1,	2005–Dec.	31,	2005	9%	23	577
Jan.	1,	2006–Mar.	31,	2006	9%	23	577
Apr.	1,	2006–Jun.	30,	2006	9%	23	577
Jul.	1,	2006–Sep.	30,	2006	10%	25	579
Oct.	1,	2006–Dec.	31,	2006	10%	25	579
Jan.	1,	2007–Mar.	31,	2007	10%	25	579
Apr.	1,	2007–Jun.	30,	2007	10%	25	579
Jul.	1,	2007–Sep.	30,	2007	10%	25	579
Oct.	1,	2007–Dec.	31,	2007	10%	25	579
Jan.	1,	2008–Mar.	31,	2008	9%	71	625
Apr.	1,	2008–Jun.	30,	2008	8%	69	623
Jul.	1,	2008–Sep.	30,	2008	7%	67	621
Oct.	1,	2008–Dec.	31,	2008	8%	69	623
Jan.	1,	2009–Mar.	31,	2009	7%	19	573
Apr.	1,	2009–Jun.	30,	2009	6%	17	571
Jul.	1,	2009–Sep.	30,	2009	6%	17	571
Oct.	1,	2009–Dec.	31,	2009	6%	17	571
Jan.	1,	2010–Mar.	31,	2010	6%	17	571
Apr.	1,	2010–Jun.	30,	2010	6%	17	571
Jul.	1,	2010–Sep.	30,	2010	6%	17	571
Oct.	1,	2010–Dec.	31,	2010	6%	17	571
Jan.	1,	2011–Mar.	31,	2011	5%	15	569
Apr.	1,	2011–Jun.	30,	2011	6%	17	571
Jul.	1,	2011–Sep.	30,	2011	6%	17	571
Oct.	1,	2011–Dec.	31,	2011	5%	15	569
Jan.	1,	2012–Mar.	31,	2012	5%	63	617
Apr.	1,	2012–Jun.	30,	2012	5%	63	617

Jul.	1,	2012–Sep.	30,	2012	5%	63	617
Oct.	1,	2012–Dec.	31,	2012	5%	63	617
Jan.	1,	2013–Mar.	31,	2013	5%	15	569
Apr.	1,	2013–Jun.	30,	2013	5%	15	569
Jul.	1,	2013–Sep.	30,	2013	5%	15	569
Oct.	1,	2013–Dec.	31,	2013	5%	15	569
Jan.	1,	2014–Mar.	31,	2014	5%	15	569
Apr.	1,	2014–Jun.	30,	2014	5%	15	569
Jul.	1,	2014–Sep.	30,	2014	5%	15	569
Oct.	1,	2014–Dec.	31,	2014	5%	15	569
Jan.	1,	2015–Mar.	31,	2015	5%	15	569
Apr.	1,	2015–Jun.	30,	2015	5%	15	569
Jul.	1,	2015–Sep.	30,	2015	5%	15	569
Oct.	1,	2015–Dec.	31,	2015	5%	15	569
Jan.	1,	2016–Mar.	31,	2016	5%	63	617
Apr.	1,	2016–Jun.	30,	2016	6%	65	619
Jul.	1,	2016–Sep.	30,	2016	6%	65	619
Oct.	1,	2016–Dec.	31,	2016	6%	65	619
Jan.	1,	2017–Mar.	31,	2017	6%	17	571
Apr.	1,	2017–Jun.	30,	2017	6%	17	571
Jul.	1,	2017–Sep.	30,	2017	6%	17	571
Oct.	1,	2017–Dec.	31,	2017	6%	17	571
Jan.	1,	2018–Mar.	31,	2018	6%	17	571
Apr.	1,	2018–Jun.	30,	2018	7%	19	573
Jul.	1,	2018–Sep.	30,	2018	7%	19	573
Oct.	1,	2018–Dec.	31,	2018	7%	19	573
Jan.	1,	2019–Mar.	31,	2019	8%	21	575
Apr.	1,	2019–Jun.	30,	2019	8%	21	575
Jul.	1,	2019–Sep.	30,	2019	7%	19	573
Oct.	1,	2019–Dec.	31,	2019	7%	19	573
Jan.	1,	2020–Mar.	31,	2020	7%	67	621
Apr.	1,	2020–Jun.	30,	2020	7%	67	621
Jul.	1,	2020–Sep.	30,	2020	5%	63	617
Oct.	1,	2020–Dec.	31,	2020	5%	63	617
Jan.	1,	2021–Mar.	31,	2021	5%	15	569

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING \$10,000
FROM JANUARY 1, 1995 – PRESENT

					1995-1 C.B.		
					RATE	TABLE	PG
Jan.	1,	1995–Mar.	31,	1995	6.5%	18	572
Apr.	1,	1995–Jun.	30,	1995	7.5%	20	574
Jul.	1,	1995–Sep.	30,	1995	6.5%	18	572
Oct.	1,	1995–Dec.	31,	1995	6.5%	18	572
Jan.	1,	1996–Mar.	31,	1996	6.5%	66	620
Apr.	1,	1996–Jun.	30,	1996	5.5%	64	618
Jul.	1,	1996–Sep.	30,	1996	6.5%	66	620
Oct.	1,	1996–Dec.	31,	1996	6.5%	66	620
Jan.	1,	1997–Mar.	31,	1997	6.5%	18	572
Apr.	1,	1997–Jun.	30,	1997	6.5%	18	572
Jul.	1,	1997–Sep.	30,	1997	6.5%	18	572
Oct.	1,	1997–Dec.	31,	1997	6.5%	18	572
Jan.	1,	1998–Mar.	31,	1998	6.5%	18	572
Apr.	1,	1998–Jun.	30,	1998	5.5%	16	570
Jul.	1,	1998–Sep.	30,	1998	5.5%	16	570
Oct.	1,	1998–Dec.	31,	1998	5.5%	16	570
Jan.	1,	1999–Mar.	31,	1999	4.5%	14	568
Apr.	1,	1999–Jun.	30,	1999	5.5%	16	570
Jul.	1,	1999–Sep.	30,	1999	5.5%	16	570
Oct.	1,	1999–Dec.	31,	1999	5.5%	16	570
Jan.	1,	2000–Mar.	31,	2000	5.5%	64	618
Apr.	1,	2000–Jun.	30,	2000	6.5%	66	620
Jul.	1,	2000–Sep.	30,	2000	6.5%	66	620
Oct.	1,	2000–Dec.	31,	2000	6.5%	66	620
Jan.	1,	2001–Mar.	31,	2001	6.5%	18	572
Apr.	1,	2001–Jun.	30,	2001	5.5%	16	570
Jul.	1,	2001–Sep.	30,	2001	4.5%	14	568
Oct.	1,	2001–Dec.	31,	2001	4.5%	14	568
Jan.	1,	2002–Mar.	31,	2002	3.5%	12	566
Apr.	1,	2002–Jun.	30,	2002	3.5%	12	566
Jul.	1,	2002–Sep.	30,	2002	3.5%	12	566
Oct.	1,	2002–Dec.	31,	2002	3.5%	12	566
Jan.	1,	2003–Mar.	31,	2003	2.5%	10	564
Apr.	1,	2003–Jun.	30,	2003	2.5%	10	564
Jul.	1,	2003–Sep.	30,	2003	2.5%	10	564
Oct.	1,	2003–Dec.	31,	2003	1.5%	8	562
Jan.	1,	2004–Mar.	31,	2004	1.5%	56	610
Apr.	1,	2004–Jun.	30,	2004	2.5%	58	612

Jul.	1,	2004–Sep.	30,	2004	1.5%	56	610
Oct.	1,	2004–Dec.	31,	2004	2.5%	58	612
Jan.	1,	2005–Mar.	31,	2005	2.5%	10	564
Apr.	1,	2005–Jun.	30,	2005	3.5%	12	566
Jul.	1,	2005–Sep.	30,	2005	3.5%	12	566
Oct.	1,	2005–Dec.	31,	2005	4.5%	14	568
Jan.	1,	2006–Mar.	31,	2006	4.5%	14	568
Apr.	1,	2006–Jun.	30,	2006	4.5%	14	568
Jul.	1,	2006–Sep.	30,	2006	5.5%	16	570
Oct.	1,	2006–Dec.	31,	2006	5.5%	16	570
Jan.	1,	2007–Mar.	31,	2007	5.5%	16	570
Apr.	1,	2007–Jun.	30,	2007	5.5%	16	570
Jul.	1,	2007–Sep.	30,	2007	5.5%	16	570
Oct.	1,	2007–Dec.	31,	2007	5.5%	16	570
Jan.	1,	2008–Mar.	31,	2008	4.5%	62	616
Apr.	1,	2008–Jun.	30,	2008	3.5%	60	614
Jul.	1,	2008–Sep.	30,	2008	2.5%	58	612
Oct.	1,	2008–Dec.	31,	2008	3.5%	60	614
Jan.	1,	2009–Mar.	31,	2009	2.5%	10	564
Apr.	1,	2009–Jun.	30,	2009	1.5%	8	562
Jul.	1,	2009–Sep.	30,	2009	1.5%	8	562
Oct.	1,	2009–Dec.	31,	2009	1.5%	8	562
Jan.	1,	2010–Mar.	31,	2010	1.5%	8	562
Apr.	1,	2010–Jun.	30,	2010	1.5%	8	562
Jul.	1,	2010–Sep.	30,	2010	1.5%	8	562
Oct.	1,	2010–Dec.	31,	2010	1.5%	8	562
Jan.	1,	2011–Mar.	31,	2011	0.5%*		
Apr.	1,	2011–Jun.	30,	2011	1.5%	8	562
Jul.	1,	2011–Sep.	30,	2011	1.5%	8	562
Oct.	1,	2011–Dec.	31,	2011	0.5%*		
Jan.	1,	2012–Mar.	31,	2012	0.5%*		
Apr.	1,	2012–Jun.	30,	2012	0.5%*		
Jul.	1,	2012–Sep.	30,	2012	0.5%*		
Oct.	1,	2012–Dec.	31,	2012	0.5%*		
Jan.	1,	2013–Mar.	31,	2013	0.5%*		
Apr.	1,	2013–Jun.	30,	2013	0.5%*		
Jul.	1,	2013–Sep.	30,	2013	0.5%*		
Oct.	1,	2013–Dec.	31,	2013	0.5%*		
Jan.	1,	2014–Mar.	31,	2014	0.5%*		
Apr.	1,	2014–Jun.	30,	2014	0.5%*		
Jul.	1,	2014–Sep.	30,	2014	0.5%*		
Oct.	1,	2014–Dec.	31,	2014	0.5%*		

Jan.	1,	2015–Mar.	31,	2015	0.5%*		
Apr.	1,	2015–Jun.	30,	2015	0.5%*		
Jul.	1,	2015–Sep.	30,	2015	0.5%*		
Oct.	1,	2015–Dec.	31,	2015	0.5%*		
Jan.	1,	2016–Mar.	31,	2016	0.5%*		
Apr.	1,	2016–Jun.	30,	2016	1.5%	56	610
Jul.	1,	2016–Sep.	30,	2016	1.5%	56	610
Oct.	1,	2016–Dec.	31,	2016	1.5%	56	610
Jan.	1,	2017–Mar.	31,	2017	1.5%	8	562
Apr.	1,	2017–Jun.	30,	2017	1.5%	8	562
Jul.	1,	2017–Sep.	30,	2017	1.5%	8	562
Oct.	1,	2017–Dec.	31,	2017	1.5%	8	562
Jan.	1,	2018–Mar.	31,	2018	1.5%	8	562
Apr.	1,	2018–Jun.	30,	2018	2.5%	10	564
Jul.	1,	2018–Sep.	30,	2018	2.5%	10	564
Oct.	1,	2018–Dec.	31,	2018	2.5%	10	564
Jan.	1,	2019–Mar.	31,	2019	3.5%	12	566
Apr.	1,	2019–Jun.	30,	2019	3.5%	12	566
Jul.	1,	2019–Sep.	30,	2019	2.5%	10	564
Oct.	1,	2019–Dec.	31,	2019	2.5%	10	564
Jan.	1,	2020–Mar.	31,	2020	2.5%	58	612
Apr.	1,	2020–Jun.	30,	2020	2.5%	58	612
Jul.	1,	2020–Sep.	30,	2020	0.5%*		
Oct.	1,	2020–Dec.	31,	2020	0.5%*		
Jan.	1,	2021–Mar.	31,	2021	0.5%*		

* The asterisk reflects the interest factors for daily compound interest for annual rates of 0.5 percent published in Appendix A of this Revenue Ruling.

T.D. 9912**DEPARTMENT OF THE
TREASURY
Internal Revenue Service
26 CFR Part 1****Guidance Clarifying
Premium Tax Credit
Unaffected by Suspension
of Personal Exemption
Deduction**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document includes final regulations under sections 36B and 6011 of the Internal Revenue Code (Code) that clarify that the reduction of the personal exemption deduction to zero for taxable years beginning after December 31, 2017, and before January 1, 2026, does not affect an individual taxpayer's ability to claim the premium tax credit. These final regulations affect individuals who claim the premium tax credit.

DATES: **Effective date:** These final regulations are effective on December 1, 2020.

Applicability date: These final regulations apply to taxable years ending on or after December 31, 2020.

FOR FURTHER INFORMATION CONTACT: Suzanne R. Sinno at (202) 317-4718 or Lisa Mojiri-Azad at (202) 317-4649 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:**Background and Explanation of Provisions***I. Overview*

This document contains final amendments to the Income Tax Regulations (26

CFR part 1) under sections 36B and 6011 of the Code.

Section 151 of the Code generally allows a taxpayer to claim a personal exemption deduction, based on the exemption amount defined in section 151(d), for the taxpayer, the taxpayer's spouse, and any dependents, as defined in section 152 of the Code. On December 22, 2017, section 151(d)(5) was added to the Code by section 11041 of Public Law 115-97, 131 Stat. 2054, 2082, commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 151(d)(5)(A) provides that, for taxable years beginning after December 31, 2017, and before January 1, 2026, "[t]he term 'exemption amount' means zero." However, section 151(d)(5)(B) provides that the reduction of the exemption amount to zero is not taken into account in determining whether a deduction under section 151 is allowed or allowable to a taxpayer, or whether a taxpayer is entitled to a deduction under section 151, for purposes of any other provision of the Code. The conference report to the TCJA states that this provision clarifies that the reduction of the personal exemption to zero "should not alter the operation of those provisions of the Code which refer to a taxpayer allowed a deduction . . . under section 151." See H.R. Rep. No. 115-466 at 203 n.16 (Conf. Rep.) (2017).

Beginning in 2014, under the Patient Protection and Affordable Care Act, Public Law 111-148 (124 Stat. 119 (2010)), and the Health Care and Education Reconciliation Act of 2010, Public Law 111-152 (124 Stat. 1029 (2010)) (collectively, PPACA), eligible individuals who purchase coverage under a qualified health plan through a Health Insurance Exchange (Exchange) established under section 1311 of the PPACA may claim a premium tax credit under section 36B of the Code. Several rules relating to the premium tax credit apply based on whether a taxpayer properly claims or claimed a personal exemption deduction under section 151 for the taxpayer, the taxpayer's spouse, and any dependents. These rules affect eligibility for the premium tax credit, computation of the premium tax credit, reconciliation of advance credit payments with the premium tax credit a taxpayer is allowed for the taxable year, and income tax return

filing requirements related to the premium tax credit.

II. Eligibility for, and Computation of, the Premium Tax Credit

To be eligible for the premium tax credit, an individual must be an applicable taxpayer. Under section 36B(c)(1), an applicable taxpayer generally is a taxpayer whose household income for the taxable year is at least 100 percent but not more than 400 percent of the Federal poverty line for the taxpayer's family size for the taxable year. A taxpayer's family size is equal to the number of individuals in the taxpayer's family. Section 1.36B-1(d) of the Income Tax Regulations provides the rules for determining the individuals in a taxpayer's family. Section 1.36B-1(d), as currently in effect, provides that a taxpayer's family means the individuals for whom a taxpayer properly claims a deduction for a personal exemption under section 151 for the taxable year, and further provides that family size means the number of individuals in the family. Additionally, §1.36B-2(b)(3) provides that an individual is not an applicable taxpayer if another taxpayer may claim a deduction under section 151 for the individual for a taxable year beginning in the calendar year in which the individual's taxable year begins.

Section 36B(c)(2) provides that the premium tax credit generally is not allowed for a month with respect to an individual if for that month the individual is eligible for minimum essential coverage other than coverage in the individual market. However, under a special eligibility rule in §1.36B-2(c)(4)(i), an individual who may enroll in minimum essential coverage because of a relationship to another person eligible for the coverage but for whom the other eligible person does not claim a personal exemption deduction under section 151 is treated as eligible for minimum essential coverage under such coverage only for months that the related individual is enrolled in the coverage.

Under section 36B(a), a taxpayer's premium tax credit is equal to the premium assistance credit amount for the taxable year. Section 36B(b)(1) and §1.36B-3(d) generally provide that the premium assistance credit amount is the sum of the pre-

mium assistance amounts for all coverage months in the taxable year for individuals in the taxpayer's family, as defined in §1.36B-1(d).

III. Reconciliation of Advance Credit Payments with the Premium Tax Credit

Under section 1412 of the PPACA, advance payments of the premium tax credit (advance credit payments) may be paid directly to issuers of qualified health plans on behalf of eligible individuals. The amount of advance credit payments made on behalf of a taxpayer in a taxable year is determined by a number of factors, including projections of the taxpayer's household income and family size for the taxable year. Under §1.36B-4, a taxpayer generally must reconcile all advance credit payments for coverage of any member of the taxpayer's family with the amount of the premium tax credit allowed under section 36B.

Section 1.36B-4(a)(1)(ii) provides allocation rules to reconcile advance credit payments when a taxpayer's family members are enrolled with one or more individuals who are not members of the taxpayer's family. If a taxpayer enrolls an individual and another taxpayer claims a personal exemption deduction for the individual, the allocation rules in §1.36B(a)(1)(ii)(B) apply for purposes of computing each taxpayer's premium tax credit and reconciling any advance credit payments. If advance credit payments are made for coverage of an individual for whom no taxpayer claims a personal exemption deduction, §1.36B-4(a)(1)(ii)(C) provides that the taxpayer who attested to the Exchange to the intention to claim a personal exemption deduction for the individual as part of the advance credit payment eligibility determination for coverage of the individual must reconcile the advance credit payments.

IV. Income Tax Return Filing Requirements Related to the Premium Tax Credit

Section 6011 provides the general rules for filing a return. Section 1.6011-8 requires a taxpayer who receives the benefit of advance credit payments in a taxable year to file an income tax return

for that taxable year to reconcile advance credit payments with the taxpayer's premium tax credit. The regulation further provides that if advance credit payments are made for coverage of an individual for whom no taxpayer claims a personal exemption deduction, the taxpayer who attested to the Exchange to the intention to claim a personal exemption deduction for the individual as part of the advance credit payment eligibility determination for coverage of the individual must file a tax return and reconcile the advance credit payments. Taxpayers who are required to reconcile advance credit payments or who claim the premium tax credit must complete Form 8962, *Premium Tax Credit (PTC)*, and file it with their income tax return.

V. Notice 2018-84

On November 5, 2018, the Department of the Treasury (Treasury Department) and the IRS issued Notice 2018-84, 2018-45 I.R.B. 768, which provided interim guidance clarifying that the reduction of the personal exemption deduction to zero under section 151(d)(5) does not affect the ability of individual taxpayers to claim the premium tax credit. Specifically, the notice provides that (1) a taxpayer is considered to have claimed a personal exemption deduction for himself or herself for a taxable year if the taxpayer files an income tax return for the year and does not qualify as a dependent of another taxpayer under section 152 for the year; and (2) a taxpayer is considered to have claimed a personal exemption deduction for an individual other than the taxpayer if the taxpayer is allowed a personal exemption deduction for the individual, taking into account section 151(d)(5)(B), and lists the individual's name and taxpayer identification number (TIN) on the Form 1040, *U.S. Individual Income Tax Return*, or Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, the taxpayer files for the year. The notice states that until further guidance is issued, the interim guidance described in the notice applies. The notice also states that the Treasury Department and the IRS intend to amend the regulations under sections 36B and 6011 to clarify the application of section 151(d)(5).

VI. Proposed Regulations

On May 27, 2020, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-124810-19) in the **Federal Register** (85 FR 31710) under section 36B. The notice of proposed rulemaking announced that the regulations currently in effect would be amended to reflect the guidance in Notice 2018-84. Specifically, §1.36B-1(d), as proposed, would define the term family to mean the taxpayer, including both spouses in the case of a joint return, except for individuals who qualify as a dependent of another taxpayer under section 152, and any other individual for whom the taxpayer is allowed a personal exemption deduction and whom the taxpayer properly reports on the taxpayer's income tax return for the taxable year. Consistent with Notice 2018-84, the proposed regulations would provide that an individual is reported on the taxpayer's income tax return if the individual's name and taxpayer identification number (TIN) are listed on the taxpayer's Form 1040 series return. To conform to §1.36B-1(d) as proposed, §§1.36B-2, 1.36B-4, and 1.6011-8 would be amended. These amendments as proposed would apply for taxable years ending after the date of publication of the final regulations in the **Federal Register**.

VII. Final Regulations

No comments responsive to the subject of the notice of proposed rulemaking were received. There were no requests for a public hearing on the proposed regulations, so no public hearing was held. Accordingly, the Treasury Department and the IRS are finalizing the proposed regulations with no changes. The final regulations are applicable for taxable years ending on or after December 31, 2020. However, taxpayers may apply the final regulations for taxable years to which section 151(d)(5) applies ending before December 31, 2020. See section 7805(b)(7).

Special Analyses

These final regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) be-

tween the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the final regulations affect individual taxpayers, not entities. Accordingly, the Secretary certifies that the rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f), these final regulations have been submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on their impact on small business (85 FR 31710). No comments on the notice were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million (updated annually for inflation). This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or

preempt state law within the meaning of the Executive Order.

Statement of Availability of IRS Documents

The regulations, notices and other guidance cited in this preamble are generally published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

Drafting Information

The principal author of these final regulations is Suzanne R. Sinno of the Office of Associate Chief Counsel (Income Tax and Accounting). Other personnel from the Treasury Department and the IRS participated in the development of the regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.36B-0 is amended by:

1. Revising the entries for §1.36B-1(d) and (o).

2. Revising the entries for §1.36B-2(c)(4)(i) and (e).

3. Revising the entries for §1.36B-4(a)(1)(ii)(B) and (C).

4. Revising the entry for §1.36B-4(c).

The revisions read as follows:

§1.36B-1 Premium tax credit definitions.

* * * * *

(d) Family and family size.

(1) In general.

(2) Special rule for tax years to which section 151(d)(5) applies.

* * * * *

(o) Applicability dates.

§1.36B-2 Eligibility for premium tax credit.

* * * * *

(c) * * *

(4) * * *

(i) Related individual.

* * * * *

(e) Applicability dates.

§1.36B-4 Reconciling the premium tax credit with advance credit payments.

* * * * *

(a) * * *

(1) * * *

(ii) * * *

(B) Individuals enrolled by a taxpayer and claimed by another taxpayer.

(C) Responsibility for advance credit payments for an individual not reported on any taxpayer’s return.

* * * * *

(c) Applicability dates.

* * * * *

Par. 3. Section 1.36B-1 is amended by

1. Redesignating paragraph (d) as paragraph (d)(1).

2. Adding new paragraph (d) and new heading.

3. Revising the paragraph heading to newly designated paragraph (d)(1).

4. Adding paragraph (d)(2).

5. Revising paragraph (o).

The additions and revisions read as follows:

§1.36B-1 Premium tax credit definitions.

* * * * *

(d) Family and family size—(1) *In general.* * * *

(2) *Special rule for tax years to which section 151(d)(5) applies.* For taxable years to which section 151(d)(5) applies, a taxpayer’s family means the taxpayer, including both spouses in the case of a joint return, except for individuals who qualify as a dependent of another taxpayer under section 152, and any other individual for whom the taxpayer is allowed a personal exemption deduction and whom the taxpayer properly reports on the taxpayer’s income tax return for the taxable year. For purposes of this paragraph (d)

(2), an individual is reported on the taxpayer's income tax return if the individual's name and taxpayer identification number (TIN) are listed on the taxpayer's Form 1040 series return. See §601.602 of this chapter.

(o) *Applicability dates.* (1) Except for paragraphs (d)(2), (l), and (m) of this section, this section applies to taxable years ending after December 31, 2013.

(2) Paragraph (d)(2) of this section applies to taxable years ending on or after December 31, 2020.

(3) Paragraphs (l) and (m) of this section apply to taxable years beginning after December 31, 2018. Paragraphs (l) and (m) of §1.36B-1 as contained in 26 CFR part 1 edition revised as of April 1, 2016, apply to taxable years ending after December 31, 2013, and beginning before January 1, 2019.

Par. 4. Section 1.36B-2 is amended by:

1. Revising paragraph (c)(4)(i).

2. Revising the heading for paragraph (e).

3. Adding paragraph (e)(4).

The revisions and addition read as follows:

§1.36B-2 Eligibility for premium tax credit.

(c)***

(4) *Special eligibility rules—(i) Related individual.* An individual who may enroll in minimum essential coverage because of a relationship to another person eligible for the coverage, but is not included in the family, as defined in §1.36B-1(d), of the other eligible person, is treated as eligible for such minimum essential coverage only for months that the related individual is enrolled in the coverage.

(e) *Applicability dates.****

(4) Paragraph (c)(4)(i) of this section applies to taxable years ending on or after December 31, 2020.

Par. 5. Section 1.36B-4 is amended by:

1. The heading of paragraph (a)(1)(ii)(B) is revised.

2. Adding a sentence to the end of paragraph (a)(1)(ii)(B)(I).

3. Revising paragraphs (a)(1)(ii)(B)(2) and (a)(1)(ii)(C).

4. Revising the paragraph heading to paragraph (c) and adding a sentence at the end.

The additions and revisions read as follows:

§1.36B-4 Reconciling the premium tax credit with advance credit payments.

(a)***

(1)***

(ii)***

(B) *Individuals enrolled by a taxpayer and claimed by another taxpayer—(I) In general.**** For taxable years to which section 151(d)(5) applies, the claiming taxpayer is the taxpayer who properly includes the shifting enrollee in his or her family for the taxable year.

(2) *Allocation percentage.* The enrolling taxpayer and claiming taxpayer may agree on any allocation percentage between zero and one hundred percent. If the enrolling taxpayer and claiming taxpayer do not agree on an allocation percentage, the percentage is equal to the number of shifting enrollees properly included in the enrolling taxpayer's family divided by the number of individuals enrolled by the enrolling taxpayer in the same qualified health plan as the shifting enrollee.

(C) *Responsibility for advance credit payments for an individual not reported on any taxpayer's return.* If advance credit payments are made for coverage of an individual who is not included in any taxpayer's family, as defined in §1.36B-1(d), the taxpayer who attested to the Exchange to the intention to include such individual in the taxpayer's family as part of the advance credit payment eligibility determination for coverage of the individual must reconcile the advance credit payments.

(c) *Applicability dates.**** The last sentence of paragraph (a)(1)(ii)(B)(I), paragraph (a)(1)(ii)(B)(2), and paragraph (a)(1)(ii)(C) of this section apply to taxable years ending on or after December 31, 2020.

Par. 6. Section 1.6011-8 is amended by revising paragraphs (a) and (b) as follows:

§1.6011-8 Requirement of income tax return for taxpayers who claim the premium tax credit under section 36B.

(a) *Requirement of return.* Except as otherwise provided in this paragraph (a), a taxpayer who receives the benefit of advance payments of the premium tax credit (advance credit payments) under section 36B must file an income tax return for that taxable year on or before the due date for the return (including extensions of time for filing) and reconcile the advance credit payments. However, if advance credit payments are made for coverage of an individual who is not included in any taxpayer's family, as defined in §1.36B-1(d), the taxpayer who attested to the Exchange to the intention to include such individual in the taxpayer's family as part of the advance credit payment eligibility determination for coverage of the individual must file a tax return and reconcile the advance credit payments.

(b) *Applicability dates—(1) In general.* Except as provided in paragraph (b)(2) of this section, paragraph (a) of this section applies for taxable years ending on or after December 31, 2020.

(2) *Prior periods.* Paragraph (a) of this section as contained in 26 CFR part 1 edition revised as of April 1, 2016, applies to taxable years ending after December 31, 2013, and beginning before January 1, 2017. Paragraph (a) of this section as contained in 26 CFR part 1 edition revised as of April 1, 2020, applies to taxable years beginning after December 31, 2016, and ending before December 31, 2020.

Sunita Lough,
*Deputy Commissioner for Services
and Enforcement.*

Approved: September 4, 2020.

David J. Kautter,
*Assistant Secretary of the Treasury
(Tax Policy).*

(Filed by the Office of the Federal Register on November 27, 2020, 11:15 a.m., and published in the issue of the Federal Register for December 01, 2020, 85 F.R. 76976)

T.D. 9933

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

Unrelated Business Taxable Income Separately Computed for Each Trade or Business

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final rule.

SUMMARY: This document contains final regulations that provide guidance on how an exempt organization subject to the unrelated business income tax determines if it has more than one unrelated trade or business, and, if so, how the exempt organization calculates unrelated business taxable income. The final regulations also clarify that the definition of “unrelated trade or business” applies to individual retirement accounts. Additionally, the final regulations provide that inclusions of “subpart F income” and “global intangible low-taxed income” are treated in the same manner as dividends for purposes of determining unrelated business taxable income. The final regulations affect exempt organizations that are subject to the unrelated business income tax.

DATES: *Effective date:* The final regulations are effective on December 2, 2020.

Applicability date: For dates of applicability, see §§1.170A-9(k)(3), 1.509(a)-3(o), 1.512(a)-1(h), 1.512(a)-6(i), 1.512(b)-1(a)(3), 1.512(b)-1(g)(5), and 1.513-1(h).

FOR FURTHER INFORMATION CONTACT: Jonathan A. Carter at (202) 317-5800 or Stephanie N. Robbins at (202) 317-4086 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR Part 1) by adding final regulations under section 512(a)(6) of the Internal Revenue Code (Code). Section 512(a)(6) was added to the Code by section 13702 of Public Law 115-97, 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 512(a)(6) requires an exempt organization subject to the unrelated business income tax under section 511 (UBIT) that has more than one unrelated trade or business, to calculate unrelated business taxable income (UBTI), separately with respect to each such trade or business including for purposes of determining any net operating loss (NOL) deduction.

In August 2018, the Department of the Treasury (Treasury Department) and the IRS released Notice 2018-67 (2018-36 IRB 409 (Sept. 4, 2018)), which discussed and solicited comments regarding various issues arising under section 512(a)(6) and set forth interim guidance and transition rules relating to that section. The Treasury Department and the IRS received 24 comments in response to Notice 2018-67.

On April 24, 2020, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-106864-18) in the **Federal Register** (85 FR 23172) that proposed regulations to provide guidance regarding how an exempt organization subject to UBIT (hereinafter referred to as an exempt organization) determines if it has more than one unrelated trade or business, and, if so, how the exempt organization calculates UBTI under section 512(a)(6) (proposed regulations). No public hearing was requested or held. The Treasury Department and the IRS received 17 comments in response to the proposed regulations.

The proposed regulations reserved two issues for additional consideration. The first issue relates to the allocation of expenses, depreciation, and similar items shared between an exempt activity and an unrelated trade or business or between more than one unrelated trade or business. The second issue relates to changes made to the section 172 NOL deduction by the Coronavirus Aid, Relief, and Economic

Security Act, Public Law 116-136, 134 Stat. 281 (2020) (CARES Act). The Treasury Department and the IRS anticipate publishing a separate notice of proposed rulemaking that will address these issues.

After consideration of the comments received, the proposed regulations are adopted as modified by this Treasury Decision. The major areas of comment and the revisions to the proposed regulations are discussed in the following Summary of Comments and Explanation of Revisions. The comments are available for public inspection at www.regulations.gov or on request. Other minor, non-substantive modifications made to the proposed regulations and adopted in these final regulations are not discussed in the Summary of Comments and Explanation of Revisions.

Summary of Comments and Explanation of Revisions

These final regulations provide guidance on how an exempt organization determines if it has more than one unrelated trade or business, and, if so, how the exempt organization calculates UBTI under section 512(a)(6). The final regulations also clarify that the definition of “unrelated trade or business” in section 513(b) applies to individual retirement accounts and that inclusions of subpart F income and global intangible low-taxed income are treated in the same manner as dividends for purposes of section 512.

1. *Separate Unrelated Trade or Business*

Consistent with section 512(a)(6) and the proposed regulations, the final regulations provide that an exempt organization with more than one unrelated trade or business must compute UBTI separately with respect to each unrelated trade or business, without regard to the specific deduction in section 512(b)(12), including for purposes of determining any NOL deduction.

a. *NAICS 2-Digit Codes Retained*

The proposed regulations generally provided that an exempt organization must identify each of its separate unrelated trades or businesses using the first two digits of the North American Industry

Classification System code (NAICS 2-digit code) that most accurately describes the unrelated trade or business. Most commenters agreed with the proposed regulations' adoption of NAICS 2-digit codes over NAICS 6-digit codes, which Notice 2018-67, for purposes of interim guidance, provided was a reasonable way to identify separate trades or businesses. One commenter discussed how the use of NAICS 2-digit codes balances the legislative intent of not allowing the losses from one unrelated trade or business to offset the income from another unrelated trade or business with the need for an administrable and efficient method of identifying separate unrelated trades or businesses. Other commenters agreed that NAICS 2-digit codes offer the most administrable and least burdensome method of identifying separate unrelated trades or businesses for both exempt organizations and the IRS.

One commenter disagreed with the use of NAICS 2-digit codes to identify separate unrelated trades or businesses. This commenter noted that, in passing the TCJA, Congress intended to limit exempt organizations' use of tax benefits that are unrelated to their tax-exempt purpose or purposes, and the commenter asserted that the proposed regulations reversed this congressional intent by identifying separate unrelated trades or businesses using the twenty broad categories provided by NAICS 2-digit codes. This commenter recommended instead that the rules relating to the qualified business deduction under section 199A for identifying a separate trade or business should be used for purposes of section 512(a)(6). The regulations under section 199A provide that the term "trade or business" has the same meaning as in section 162. The commenter contended that enough case law exists with respect to section 162 to define "trade or business" and that the section 199A regulations have provided practitioners with enough experience to identify a trade or business using this definition.

The final regulations do not adopt the approach taken by the section 199A regulations as a method of identifying separate unrelated trades or businesses for purposes of section 512(a)(6) because, although sections 199A and 512(a)(6) were both enacted as part of the TCJA, they serve different purposes. Section

199A, in part, provides individuals, estates, and certain trusts a deduction of up to 20 percent of business income from certain domestic trades or businesses. Such taxpayers might be engaged in one or more trades or businesses for which they may be entitled to the section 199A deduction. For purposes of computing the section 199A deduction, taxpayers are required to determine the specific lines between trades or businesses to ensure that only qualified items of income and expense traced to each qualified trade or business are used to compute the deduction and that the W-2 wage and unadjusted basis immediately after acquisition (UBIA) limitations are properly applied. Therefore, the section 199A regulations look to section 162 to determine how these lines should be drawn. By contrast, section 512 looks to section 162 to determine whether a trade or business exists but employs a simplified regime to identify separate unrelated trades or businesses under section 512(a)(6) for exempt organizations because they are not primarily engaged in section 162 for-profit trades or businesses. The regime also applies for a more limited purpose, that is preventing exempt organizations from using losses of one unrelated trade or business to offset the gains of any other unrelated trade or business, and uniformly to all of an exempt organization's separate unrelated trades or businesses. The Treasury Department and IRS believe that using NAICS 2-digit codes in this context provides an objective means to identify separate trades or businesses consistent with Congress's intent without imposing an undue burden on exempt organizations. Accordingly, the final regulations under section 512(a)(6) do not adopt this comment.

b. No Additional Methods of Identifying Separate Unrelated Trades or Businesses

One commenter recommended that NAICS 2-digit codes be used as a safe-harbor and that a facts and circumstances test be applied as the primary method of identifying separate unrelated trades or businesses. This commenter asserted that a facts and circumstances test would be more consistent with other parts of the Code (including the regulations under

section 199A) and would provide a more flexible framework for variations in activities across exempt organizations. This commenter proposed considering multiple factors for identifying separate trades or businesses that would include the interdependence of the activities, the geographic location of the activities, and the relationship the exempt organization has with the operation of the activity. The commenter opined that a facts and circumstances test would help alleviate any inequity caused by section 512(a)(6).

As explained both in Notice 2018-67 and the preamble to the proposed regulations, Congress did not provide any explicit criteria for determining whether an exempt organization has "more than one unrelated trade or business" or for identifying "separate" unrelated trades or businesses for purposes of calculating UBTI in accordance with section 512(a)(6). The Joint Committee on Taxation (JCT) noted that "it is intended that the Secretary issue guidance concerning when an activity will be treated as a separate unrelated trade or business for purposes of [section 512(a)(6)]." Staff of the Joint Committee on Taxation, General Explanation of Pub. L. 115-97 (December 2018), at 293 (General Explanation). Notice 2018-67 stated that the Treasury Department and the IRS would like to set forth a more administrable method than a facts and circumstances test for identifying separate unrelated trades or businesses. Nonetheless, the Treasury Department and the IRS considered a facts and circumstances test as a method of identifying separate unrelated trades or businesses in response to comments received following the enactment of section 512(a)(6) and again in response to Notice 2018-67. The factors suggested by commenters, and previously considered, generally were derived from other Code provisions, such as sections 132, 162, 183, 414, and 469. However, these Code provisions primarily consider whether an activity is a trade or business and not whether one trade or business is "separate" from another. Accordingly, the Treasury Department and the IRS continue to consider these Code provisions, alone or in conjunction with each other, as unhelpful models for identifying separate trades or businesses for purposes of section 512(a)(6).

It continues to be the case that adoption of a facts and circumstances test, as the only identification method or in addition to a safe harbor using NAICS 2-digit codes, would increase the administrative burden on exempt organizations in complying with section 512(a)(6) because a fact-intensive analysis would be required with respect to each unrelated trade or business. Additionally, adoption of a facts and circumstances test would offer exempt organizations less certainty and likely result in inconsistency among exempt organizations conducting more than one unrelated trade or business because of differing approaches exempt organizations would take in applying such a test. Also, a facts and circumstances test would increase the administrative burden on the IRS, which, upon examination, must perform the same fact-intensive analysis with respect to each of the unrelated trades or businesses identified by the exempt organization for purposes of calculating UBTI. Accordingly, the final regulations do not adopt a facts and circumstances test in addition to or in place of NAICS 2-digit codes as a method of identifying separate unrelated trades or businesses for purposes of section 512(a)(6).

c. Identifying the Appropriate NAICS 2-Digit Code

The proposed regulations provided that an exempt organization's separate unrelated trades or businesses are determined based on the applicable NAICS 2-digit code. Before an exempt organization can identify its "separate" unrelated trades or businesses, it must first determine whether it regularly carries on unrelated trades or businesses within the meaning of sections 511 through 514. Section 1.513-1(a) clarifies that, unless one of the specific exceptions of section 512 or 513 applies, gross income of an exempt organization is includible in the computation of UBTI if: (1) it is income from a trade or business; (2) such trade or business is regularly carried on by the organization; and (3) the conduct of such trade or business is not substantially related (other than through the production of funds) to the

organization's performance of its exempt functions. Accordingly, the final regulations provide that an exempt organization determines whether it carries on unrelated trades or businesses by applying sections 511 through 514. Under the final regulations, the exempt organization then identifies its separate unrelated trades or businesses for purposes of section 512(a)(6) using the methods described in the final regulations. With respect to most unrelated trade or business activities, an exempt organization determines whether those activities are separate unrelated trades or businesses for purposes of section 512(a)(6) based on the most accurate NAICS 2-digit codes describing the activities.

Several commenters requested additional guidance regarding how to choose the "most accurate" NAICS 2-digit code. These commenters suggested that strict adherence to NAICS 2-digit codes can result in unrelated trade or business activities that the exempt organization considers to be one unrelated trade or business being separated into two or more unrelated trades or businesses. Other commenters requested that aggregation of NAICS 2-digit codes be allowed in certain circumstances. The commenters provided examples of unrelated trade or business activities that they considered to be one unrelated trade or business but that may be identified as more than one unrelated trade or business when using NAICS 2-digit codes.

For example, one commenter stated that an organization operating a gift shop that sells clothing, electronics, and books in a bricks-and-mortar store and online would report those activities under two different NAICS 2-digit codes – one for the sale of clothing and electronics (44) and one for books and online sales (45). Another example provided by a commenter is a museum that provides catering services, valet parking, and personal property rentals as part of a package for special events, such as weddings, held on its premises. The commenter noted that the museum may be required to identify these activities using three different NAICS 2-digit codes – one for catering (72), one for parking (81), and one for rentals (53). The commenter posit-

ed that the museum should be able to treat this activity as one trade or business based on a reasonable and common sense understanding of the service provided (hosting an event), rather than the various components of the provided services.

The Treasury Department and the IRS note that NAICS 2-digit codes aggregate trade or business activities into only 20 separate trades or businesses, compared to the more than 1,000 trades or businesses identified at the NAICS 6-digit code level. Like the proposed regulations, the final regulations provide that a separate unrelated trade or business is identified by the NAICS 2-digit code that most accurately describes the exempt organization's trade or business activity. In addition, the final regulations add that this determination is based on the more specific NAICS code, such as at the 6-digit level, that describes the activity that it conducts. The final regulations also state that the descriptions in the current NAICS manual (available at www.census.gov) of trades or businesses using more than two digits of the NAICS codes are relevant in this determination. In response to commenter examples, the final regulations incorporate a rule used in NAICS for identifying certain industries¹ and provide that, in the case of the sale of goods, both online and in stores, the separate unrelated trade or business is identified by the goods sold in stores if the same goods generally are sold both online and in stores.

With respect to the museum example, the Treasury Department and the IRS note that income from activities that is appropriately characterized as income from rentals is generally exempt from UBTI under section 512(b)(3). The analysis of whether an activity produces rental income depends, in part, on whether other services are provided by the exempt organization in connection with the possible rental activity (such as providing space for a wedding). To the extent other services are provided, income from the use of space may cease to be rent from real property and instead take on the character of the services provided. *See* §1.512(b)-1(c)(5). Exempt organizations already need to do this analysis of the facts and

¹ The NAICS code for "Electronic Shopping and Mail-Order Houses" provides that "Store retailing or a combination of store retailing and nonstore retailing in the same establishment—are classified in Sector 44-45, Retail Trade, based on the classification of the store portion of the activity."

circumstances to determine their UBTI. Similarly, whether services provided in connection with hosting an event should be aggregated or not depends on the facts and circumstances, including the language of the contract or contracts, the services provided, who is providing the services, etc. It is possible that the activities could be separate trades or businesses based on the fragmentation rule contained in section 513(c) and §1.513-1(b) (“[a]ctivities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization”).

Because NAICS at the 2-digit code level aggregates all trade or business activities into only 20 separate trades or businesses, many trade or business activities that could be considered separate trades or businesses, such as the provision of food or lodging, are already aggregated into broad categories (NAICS code 72 includes both lodging and food services) and therefore treated as one trade or business under the final regulations. Accordingly, if an exempt organization determines that, based on the facts and circumstances, its trade or business activities must be separated into two or more unrelated trades or businesses under NAICS 2-digit codes, the Treasury Department and the IRS view that result as appropriate to achieve the balance of tax administrability and carrying out the purposes of section 512(a)(6). Thus, under the final regulations, if trade or business activities would be best described by different NAICS 2-digit codes, those activities should be identified using different NAICS 2-digit codes and treated as separate unrelated trades or businesses.

In addition, consistent with the proposed regulations, the final regulations continue to provide that the NAICS 2-digit code must identify the separate unrelated trade or business in which the exempt organization engages (directly or indirectly). The NAICS 2-digit code cannot describe activities the conduct of which are substantially related to the exercise or performance by such organization of its charitable, educational, or other

purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a)(2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)). For example, a college or university described in section 501(c)(3) or 511(a)(2)(B) cannot use the NAICS 2-digit code for educational services to identify all of its separate unrelated trades or businesses, and a qualified retirement plan described in section 401(a) cannot use the NAICS 2-digit code for finance and insurance to identify all of its unrelated trades or businesses.

Also consistent with the proposed regulations, the final regulations continue to provide that an organization will report each NAICS 2-digit code only once. The Treasury Department and the IRS note that this rule permits exempt organizations to aggregate trade or business activities that may occur in different geographic locations. The final regulations include the same example as provided by the proposed regulations — the pharmacies operated in different geographic locations that are one unrelated trade or business for purposes of section 512(a)(6) because the pharmacy trade or business is identified using one NAICS 2-digit code.

d. Changing NAICS 2-Digit Codes

The proposed regulations generally provided that, once an organization has identified a separate unrelated trade or business using a particular NAICS 2-digit code, the organization cannot change the NAICS 2-digit code describing that separate unrelated trade or business unless two requirements are met. First, the exempt organization must show that the NAICS 2-digit code chosen was due to an unintentional error. Second, the exempt organization must show that another NAICS 2-digit code more accurately describes the unrelated trade or business. The preamble to the proposed regulations stated that the instructions to the Form 990-T, “Exempt Organization Business Income Tax Return,” would be updated to describe how an exempt organization notifies the IRS of a change in a NAICS 2-digit code due to an unintentional error.

At least one commenter requested clarification regarding what is meant by

“unintentional error.” Commenters also suggested that the final regulations should include additional circumstances in which exempt organizations can change the NAICS 2-digit code describing a separate unrelated trade or business. Several commenters explained that the nature of a separate unrelated trade or business may change or evolve to the extent that the unrelated trade or business would be more accurately reported under a different NAICS 2-digit code. One commenter likened this shift in trade or business activities to the commencement of a new unrelated trade or business. Accordingly, these commenters recommended that an exempt organization be permitted to change the NAICS 2-digit code identifying a separate unrelated trade or business if a change in the unrelated business activity results in it being better described by a different NAICS 2-digit code. Finally, one commenter requested that a code change be permitted if the exempt organization’s tax preparer reasonably believes that an unrelated trade or business activity is more accurately described by a different NAICS 2-digit code.

Several commenters also requested clarification of the process for reporting an erroneous code. One commenter recommended that the instructions to the Form 990-T clarify that an exempt organization should provide such notification to the IRS on the Form 990-T — including an explanation of the change and any necessary supporting information — and that such change would be effective on the first day of the taxable year beginning after the taxable year for which the Form 990-T providing such notification is filed. This commenter also questioned whether reconciliation was required for the prior taxable year or years in which the erroneous code was used and, if so, how an adjustment resulting from such reconciliation would be applied.

In response to these comments, the final regulations remove the restriction on changing NAICS 2-digit codes. Instead, the final regulations require an exempt organization that changes the identification of a separate unrelated trade or business to report the change in the taxable year of the change in accordance with forms and instructions. See section 6012(a)(2) and §1.6012-2(e). The final regulations clarify that a change in identification of a sepa-

rate unrelated trade or business includes the changed identification of the separate unrelated trade or business with respect to a partnership interest that was incorrectly designated as a qualifying partnership interest (discussed in part 2.b of this Summary of Comments and Explanation of Revisions). To report the change in identification, the final regulations require an organization to provide certain information with respect to each separate unrelated trade or business the identification of which changes: the identification of the separate unrelated trade or business in the previous taxable year, the identification of the separate unrelated trade or business in the current taxable year, and the reason for the change. The Treasury Department and the IRS anticipate that the instructions to the Form 990-T will be revised for taxable years for which the final regulations are effective to provide instructions regarding where and how changes in identification are reported. The effect on NOLs caused by changes of the identification of separate unrelated trades or businesses are discussed in part 6.d of this Summary of Comments and Explanation of Revisions.

e. Transition from NAICS 6-Digit Codes to NAICS 2-Digit Codes

The preamble to the proposed regulations provided that, for taxable years beginning before the date the proposed regulations are published in the **Federal Register** as final regulations, an exempt organization may rely on a reasonable, good-faith interpretation of sections 511 through 514, considering all the facts and circumstances, when identifying separate unrelated trades or businesses for purposes of section 512(a)(6). The preamble to the proposed regulations provided that an exempt organization could rely on the proposed regulations in their entirety or, alternatively, the methods of aggregating or identifying separate trades or businesses provided in Notice 2018-67, which provided that a reasonable, good-faith interpretation included using NAICS 6-digit codes.

One commenter recommended that the final regulations confirm that an exempt organization that reported separate unrelated trades or businesses using NAICS 6-digit codes in taxable years beginning

prior to the exempt organization's first taxable year for which the final regulations are effective can reclassify their activities using NAICS 2-digit codes without having to report an unintentional error.

As discussed in the Applicability Dates section of this preamble, these final regulations are applicable to taxable years beginning on or after December 2, 2020. Although an exempt organization may have used NAICS 6-digit codes to identify its separate unrelated trades or businesses in taxable years beginning before this date, the transition from NAICS 6-digit codes to NAICS 2-digit codes does not require the reporting of a code change because the exempt organization will be using the same NAICS code to identify its separate unrelated trades or businesses – just with fewer digits. The move from NAICS 6-digit codes to NAICS 2-digit codes may result in the combination of NOLs if an exempt organization has trade or business activities that would be separate unrelated trades or businesses if identified using NAICS 6-digit codes but would be one unrelated trade or business if identified using NAICS 2-digit codes. An exempt organization may choose, but is not required, to amend Forms 990-T filed prior to December 2, 2020 to report separate unrelated trades or businesses using NAICS 2-digit codes.

f. No De Minimis Exception Provided

The preamble to the proposed regulations discussed one comment with respect to Notice 2018-67 that suggested the Treasury Department and the IRS adopt a de minimis exception for exempt organizations reporting less than \$100,000 of gross UBTI. The preamble to the proposed regulations explained that the Treasury Department and the IRS declined to adopt the comment because section 512(a)(6) does not provide discretionary authority for the Treasury Department and the IRS to establish a de minimis exception. Further, the preamble to the proposed regulations explained that, even at a lower threshold, a de minimis test would be contrary to the stated congressional intent of not permitting exempt organizations to use losses from one unrelated trade or business to offset the gains from another unrelated trade or business.

One commenter on the proposed regulations nonetheless recommended the adoption of a de minimis exception. This commenter proposed that an exempt organization with less than \$10,000 of total gross revenues from all unrelated trade or business activities be permitted to treat all its unrelated trades or businesses as one trade or business for purposes of section 512(a)(6). For exempt organizations with more than \$10,000 of total gross revenues from all unrelated trade or business activities, the commenter suggested aggregation of all separate unrelated trades or businesses with less than \$1,000 of total gross revenues. The commenter reasoned that exempt organizations with less than \$10,000 of total gross revenues from unrelated trade or business activities likely lack the resources necessary to comply with section 512(a)(6).

The commenter attempted to refute the argument that the Treasury Department and the IRS lack the authority to promulgate a de minimis exception by noting that the Treasury Department and the IRS already exercised discretion by permitting exempt organizations to treat their activities in the nature of investments as a separate unrelated trade or business for purposes of section 512(a)(6). The commenter cites the JCT General Explanation as confirmation that the Treasury Department and the IRS are authorized to permit the aggregation of separate unrelated trades or businesses.

Permitting the aggregation of certain investment activities is an administrative rule premised on the difficulty an exempt organization partner may experience in certain situations in obtaining the information needed to determine whether the trades or businesses conducted by the partnership are separate unrelated trades or businesses with respect to the exempt organization partner (see part 2 of this Summary of Comments and Explanation of Revisions for a more in depth discussion). By contrast, permitting the aggregation of “de minimis” separate unrelated trades or businesses is contrary to the congressional intent of not permitting exempt organizations to offset the losses from one unrelated trade or business with the gains from another, without regard to the amount of the gross receipts in either trade or business. Finally, the concept of a

de minimis amount of UBTI is incompatible with the fragmentation rule in section 513(c); §1.513-1(b). That is, the fragmentation rule requires the identification of unrelated trade or business activities no matter the size.

To the extent that smaller exempt organizations may have difficulty complying with section 512(a)(6), the Treasury Department and the IRS expect that adoption of NAICS 2-digit codes, as opposed to NAICS 6-digit codes, may relieve much of this burden because smaller exempt organizations are unlikely to have numerous unrelated trades or businesses under these final regulations. Furthermore, under §1.6012-2(e), an exempt organization is required to file Form 990-T only “if it has gross income, included in computing [UBTI] for such taxable year, of \$1,000 or more.” This filing threshold, which applies regardless of the number of separate unrelated trades or businesses conducted by the exempt organization, serves as a de minimis rule for small exempt organizations. Accordingly, the Treasury Department and the IRS do not adopt this comment in the final regulations for these reasons as well as the reasons cited in the preamble to the proposed regulations.

g. Allocation of Directly Connected Deductions

i. In General

Section 512(a)(1) permits an exempt organization with an unrelated trade or business to take the deductions allowed under chapter 1 of the Code (chapter 1) that are directly connected with the carrying on of such unrelated trade or business. Section 512(a)(3) similarly permits a social club described in section 501(c)(7), a voluntary employees’ beneficiary association (VEBA) described in section 501(c)(9), or a supplemental unemployment benefits trust (SUB) described in section 501(c)(17) to take the deductions allowed under chapter 1 that are directly connected with the production of gross income (excluding exempt function income). To the extent that an exempt organization may have items of deduction that are shared between an exempt activity and an unrelated trade or business, §1.512(a)-1(c) provides special rules for allocating such expenses.

For example, if facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, then expenses, depreciation, and similar items attributable to such facilities must be allocated between the two uses on a reasonable basis (reasonable basis standard).

The preamble to the proposed regulations noted that an exempt organization with more than one unrelated trade or business must not only allocate shared expenses among exempt and taxable activities as described in §1.512(a)-1(c) but also among separate unrelated trades or businesses. Accordingly, the proposed regulations incorporated the existing allocation standard in §1.512(a)-1(c) for purposes of section 512(a)(6). No comments were received regarding this approach. Accordingly, the final regulations continue to provide that an exempt organization with more than one unrelated trade or business must allocate deductions between separate unrelated trades or businesses using the reasonable basis standard described in §1.512(a)-1(c).

ii. The Unadjusted Gross-to-Gross Method Unreasonable in Certain Circumstances

The preamble to the proposed regulations did, however, describe the concerns of the Treasury Department and the IRS regarding the administrability of the reasonable basis standard. The preamble to the proposed regulations announced that the Treasury Department and the IRS would continue to consider whether the reasonable basis standard should be retained and announced the intention to publish a separate notice of proposed rulemaking. As an initial matter, however, the proposed regulations stated that allocation of expenses, depreciation, and similar items using an unadjusted gross-to-gross method is not reasonable. In general, a gross-to-gross method of allocation uses a ratio of gross income from an unrelated trade or business activity over the total gross income from both unrelated and related activities generating the same indirect expenditures. The percentage resulting from this ratio is used to determine the percentage of the shared costs attributable to the unrelated trade or business activity (or activities). If a price difference exists between the

provision of a good or service to different populations and no adjustment is made, the gross-to-gross ratio may be described as “unadjusted.”

Several commenters asserted that the unadjusted gross-to-gross method should not be considered unreasonable. Of these commenters, two stated that the gross-to-gross method can be reasonable if there is no price difference for goods or services provided in related and unrelated activities or if adjustments are made for any price differences. One commenter further argued that no allocation method should be per se unreasonable because what is unreasonable with respect to one set of facts and circumstances may be reasonable with respect to another.

In response to these commenters’ recommendations, the final regulations clarify that allocation of expenses, depreciation, and similar items is not reasonable if the cost of providing a good or service in a related and an unrelated activity is substantially the same, but the price charged for that good or service in the unrelated activity is greater than the price charged in the related activity and no adjustment is made to equalize the price difference for purposes of allocating expenses, depreciation, and similar items based on revenue between related and unrelated activities. For example, if a social club described in section 501(c)(7) charges nonmembers a higher price than it charges members for the same good or service, but does not adjust the price of the good or service provided to members for purposes of allocating expenses, depreciation, and similar items attributable to the provision of that good or service, the allocation method is not reasonable.

The Action on Decision (AOD) relating to *Rensselaer Polytechnic Institute v. Commissioner* stated that the IRS would not litigate the reasonableness of an allocation method “until the allocation rules of [§1.512(a)-1(c)] are amended.” 732 F.2d 1058 (2d Cir. 1984), *aff’g* 79 T.C. 967 (1982); AOD 1987-014 (Jun. 18, 1987). The final regulations amend the rules of §1.512(a)-1(c) and, as discussed in the Applicability Dates section of this preamble, are effective for taxable years beginning on or after December 2, 2020. Accordingly, the IRS rescinds the AOD to the limited extent of any allocation meth-

od that fails to equalize price differences between related activities and unrelated trade or business activities for such taxable years. The IRS will continue to refrain from litigating the reasonableness of other allocation methods pending the publication of further guidance, which the Treasury Department and the IRS continue to consider and expect to publish in a separate notice of proposed rulemaking.

2. Activities in the Nature of Investments

The proposed regulations treat an exempt organization's activities in the nature of an investment (investment activities) as a separate trade or business for purposes of section 512(a)(6). Several commenters repeated the suggestion previously made in response to Notice 2018-67 that the Treasury Department and the IRS should not treat an exempt organization's investment activities as an unrelated trade or business, and therefore the income and losses from these activities should not be considered for purposes of applying section 512(a)(6). The preamble to the proposed regulations explained that the Treasury Department and the IRS concluded that the structure and purposes of sections 511 through 514 indicate that an exempt organization's investment activities are an unrelated trade or business for purposes of section 512(a)(6), although certain income from such investment activities (investment income) is excluded from the calculation of UBTI under modifications in section 512(b). The Treasury Department and the IRS also noted that the language of section 512(a)(6)(B) states an organization's total UBTI is the sum of the UBTI computed for each separate unrelated trade or business under section 512(a)(6)(A). To conclude that investment income is not included in the separately computed UBTI under section 512(a)(6)(A) would be to remove such income entirely from UBTI under section 512(a)(6)(B), even when no modification in section 512(b) applies to the income. Nothing in the legislative history or the statute suggests that Congress intended to amend the items of income that are taxable under section 511. Accordingly, the final regulations continue to treat an ex-

empt organization's investment activities that are subject to UBIT as a separate unrelated trade or business for purposes of section 512(a)(6).

a. Exclusive List of Investment Activities

The proposed regulations provided an exclusive list of an exempt organization's investment activities that may be treated as a separate unrelated trade or business for purposes of section 512(a)(6). Under the proposed regulations, for most exempt organizations, such investment activities are limited to: (i) qualifying partnership interests (see part 2.b of this Summary of Comments and Explanation of Revisions); (ii) qualifying S corporation interests (see part 3.a of this Summary of Comments and Explanation of Revisions); and (iii) debt-financed properties (see part 2.d of this Summary of Comments and Explanation of Revisions).² Although commenters recommended modifications to the rules regarding the individual items included in this list, no commenters objected to the treatment of these items as investment activities. Accordingly, the final regulations adopt the list of investment activities provided in the proposed regulations without change.

Nonetheless, some commenters recommended that this exclusive list be expanded to include specified payments from controlled entities that are included in UBTI under section 512(b)(13) (discussed in part 2.a.i of this Summary of Comments and Explanation of Revisions) and certain amounts from controlled foreign corporations that are included in UBTI under section 512(b)(17) (discussed in part 2.a.ii of this Summary of Comments and Explanation of Revisions).

i. Specified Payments from Controlled Entities

Section 512(b)(13)(A) requires an exempt organization, referred to as a "controlling organization," that receives or accrues (directly or indirectly) a specified payment from another entity which it controls, referred to as a "controlled entity," to include such payment as an item of

gross income derived from an unrelated trade or business to the extent such payment reduces the net unrelated income of the controlled entity (or increases any net unrelated loss of the controlled entity). See also §1.512(b)-1(l)(1). Section 512(b)(13)(C) defines the term "specified payment" as any interest, annuity, royalty, or rent. Accordingly, section 512(b)(13) treats certain amounts that would ordinarily be excluded from the calculation of UBTI under section 512(b)(1), (2), and (3) as income derived from an unrelated trade or business.

The proposed regulations provided that, if an exempt organization controls another entity (within the meaning of section 512(b)(13)(D)), the specified payments from that controlled entity will be treated as gross income from a separate unrelated trade or business for purposes of section 512(a)(6). If a controlling organization receives specified payments from two different controlled entities, the proposed regulations treated the payments from each controlled entity as separate unrelated trades or businesses.

Two commenters recommended that income included in UBTI under section 512(b)(13) should be part of the investment activities trade or business under section 512(a)(6). These commenters noted that different fact patterns can produce different tax results because of the interaction between section 512(b)(13) and the debt-financed property rules of section 514. For example, one commenter provided a series of examples in which a wholly owned taxable subsidiary rented space from its exempt organization parent in a debt-financed property owned by the parent.

Section 1.514(b)-1(b)(2)(ii) of the current regulations states that section 514 does not apply to amounts specifically taxable under other provisions of the Code, such as rents and interest from controlled organizations includible pursuant to section 512(b)(13). Thus, if a controlling organization leases debt-financed property to a controlled organization, the amount of rents includible in the controlling organization's UBTI shall first be determined under section 512(b)(13),

²Special rules discussed in part 4 of this Summary of Comments and Explanation of Revisions apply to social clubs described in section 501(c)(7).

and only the portion of such rents not taken into account by operation of section 512(b)(13) are taken into account by operation of section 514. *See* §1.512(b)-1(l)(5)(ii). Because the regulations provide a clear ordering rule that sets section 512(b)(13) income apart from the rules of section 514, section 512(b)(13) taxable income can never be debt-financed investment income.

The Treasury Department and the IRS considered in the preamble to the proposed regulations whether specified payments should be included with an exempt organization's investment activities and concluded that this treatment would be inconsistent with the purpose of section 512(b)(13)(A), which is to prevent a controlled entity from gaining a competitive advantage (in contravention of the purposes of section 512) through making deductible payments to a controlling organization that is exempt from tax. *See* S. Rep. No. 91-552, at 73 (1969) (explaining that certain "rental" arrangements between exempt organizations and taxable subsidiaries "[enable] the taxable [subsidiary] to escape nearly all of its income taxes"). Consistent with this purpose, section 512(b)(13)(A) treats specified payments as income from an unrelated trade or business only "to the extent such payment reduces the net unrelated income of the controlled entity (or increases any net unrelated loss of the controlled entity)." Additionally, the required degree of control of the controlling organization over the controlled entity indicates that the controlled entities are not a part of the controlling organization's otherwise appropriately characterized investment activities.

Alternatively, if specified payments are not included with an exempt organization's investment activities, these commenters requested that specified payments from any source be treated as one unrelated trade or business for purposes of section 512(a)(6). The commenters asserted that the aggregation of specified payments would reduce the incentive to restructure financial transactions to obtain more favorable tax results. One commenter set out an example in which the UBTI from the separate unrelated trades or businesses for specified payments received from two controlled entities of an exempt organization differed under section 512(b)(13)

depending on whether the exempt organization owned both subsidiaries directly or one subsidiary directly and the other subsidiary indirectly through the first subsidiary. The commenter asserted that aggregating the UBTI from all the controlled entities would create the same tax result for all exempt organizations with these facts regardless of the structure of the subsidiaries and the rental payments.

The Treasury Department and the IRS continue to view specified payments as not appropriately characterized as part of an exempt organization's investment activities. Furthermore, because section 512(b)(13) views specified payments as stemming from the trade or business activity of the controlled entity rather than from its investment activities, the Treasury Department and the IRS decline to adopt the suggestion that all specified payments be treated as one unrelated trade or business for purposes of section 512(a)(6). Rather, because section 512(b)(13)(A) provides that specified payments from a controlled entity are income derived from an unrelated trade or business, the final regulations adopt the proposed regulations regarding specified payments without modification.

ii. Certain Amounts from Controlled Foreign Corporations

Section 512(b)(17) requires any amount included in gross income under section 951(a)(1)(A) to be included as an item of gross income derived from an unrelated trade or business to the extent the amount so included is attributable to insurance income (as defined in section 953) which, if derived directly by the exempt organization, would be treated as gross income from an unrelated trade or business. Section 953(a)(1) defines "insurance income" as any income that (A) is attributable to the issuing (or reinsuring) of an insurance or annuity contract, and (B) would (subject to certain modifications not relevant here) be taxed under subchapter L of chapter 1 if such income were the income of a domestic insurance company. Thus, section 512(b)(17) "applies a look-through rule in characterizing certain subpart F insurance income for unrelated business income tax purposes." H. R. Rep. No. 104-586 (1996), at 137.

The proposed regulations treated the provision of insurance by all controlled foreign corporations (CFCs) as one trade or business, regardless of whether such insurance income is received from more than one CFC, which is consistent with how NAICS would categorize the provision of insurance (52 – Finance and Insurance). However, the proposed regulations did not permit the aggregation of an exempt organization's insurance income included in UBTI under section 512(b)(17) with any insubstantial commercial-type insurance activities conducted directly by the exempt organization because the CFC, not the exempt organization, is engaged in the activity giving rise to the insurance income included in UBTI under section 512(b)(17). The insurance activity described in section 512(b)(17) is not attributed to the exempt organization and thus is distinguishable from any commercial-type insurance activity engaged in directly by the exempt organization.

One commenter recommended that amounts included in income under section 512(b)(17) should be part of an exempt organization's investment activities. This commenter questioned the statement in the preamble to the proposed regulation that "the required degree of control of the exempt organization over the controlled foreign corporation indicates that the exempt organization's interest in a controlled foreign corporation is probably not part of the exempt organization's otherwise appropriately characterized investment activities." The commenter explained that, with respect to insurance income specifically, the required ownership by United States shareholders for CFC status is reduced to 25 percent from the usual 50 percent. The commenter asserted that an exempt organization shareholder therefore could hold less than a 10 percent interest in a CFC that as a whole is owned by United States shareholders. The commenter stated that the low percentage of ownership necessary to have such amounts included in UBTI should warrant inclusion with an exempt organization's investment activities, based on the similarity to the ownership percentages for qualifying partnership interest status discussed in part 2.b of this Summary of Comments and Explanation of Revisions. However, another commenter recom-

mended retention of the rules in the proposed regulations for amounts included in income under section 512(b)(17).

As explained in the preamble to the proposed regulations, the reasons for not treating amounts included in income under section 512(b)(17) as an exempt organization's investment activities extend beyond the amount of control the exempt organization may have over the CFC. In particular, that preamble explained that insurance income included in UBTI under section 512(b)(17) should not be treated as gross income from an exempt organization's investment activities because the provision of insurance generally is an unrelated trade or business. See section 501(m) (providing that, in the case of an exempt organization described in section 501(c)(3) or (4) that does not provide commercial-type insurance as a substantial part of its activities, the activity of providing commercial-type insurance is treated as an unrelated trade or business (as defined in section 513)). Further, the percentage interest prongs of the qualifying partnership interest rules, discussed in parts 2.b.iii and 2.b.iv.A of this Summary of Comments and Explanation of Revisions, serve as a proxy for an exempt organization's ability to obtain the information necessary to identify the underlying trade or business of the partnership. For amounts included in income under section 512(b)(17), the underlying trade or business is known because the only amounts included are from the insurance activity of the CFC. Thus, the same treatment of income under section 512(b)(17) is not needed for administrative convenience.

Accordingly, the final regulations adopt without change the proposed regulations regarding the treatment of amounts included in UBTI under section 512(b)(17) for purposes of section 512(a)(6).

b. *Qualifying Partnership Interests*

In general, for exempt organizations, the activities of a partnership are considered the activities of the exempt organization partners.³ Specifically, section 512(c) states that if a trade or business regularly carried on by a partnership of which an

exempt organization is a member is an unrelated trade or business with respect to such organization, such organization shall include its share of the gross income of the partnership in UBTI. However, commenters on both Notice 2018-67 and the proposed regulations explained the difficulty of obtaining information regarding the trade or business activities of lower-tier partnerships. Therefore, as a matter of administrative convenience for both the exempt organization and the IRS, the proposed regulations permitted, but did not require, an exempt organization to aggregate its UBTI from an interest in a partnership with more than one unrelated trade or business (including unrelated trades or businesses conducted by lower-tier partnerships) if it met certain requirements (qualifying partnership interest, or QPI). Additionally, the proposed regulations permitted the aggregation of any QPI with all other QPIs, resulting in the treatment of the aggregate group of QPIs (along with associated debt-financed income under section 514 and qualifying S corporation interests, both discussed in parts 2.d and 3.a, respectively, of this Summary of Comments and Explanation of Revisions) as a single "investment activities" trade or business for purposes of section 512(a)(6) (A).

The proposed regulations identified a partnership interest as a QPI if it met the requirements of either the de minimis test (discussed in part 2.b.iii of this Summary of Comments and Explanation of Revisions) or the control test (discussed in part 2.b.iv of this Summary of Comments and Explanation of Revisions). A few commenters recommended alternative or additional tests to identify a QPI. Three commenters suggested that the generally accepted accounting principles (GAAP) codified by the Financial Accounting Standards Board (FASB) should replace the de minimis and the control tests to identify partnership interests as QPIs. These commenters recommended that any interest that is reported as "fair value" under these standards should be considered a QPI and included as part of the exempt organization's investment activities. Two other commenters recommended that a

partnership that uses an investment manager should be a QPI. For this purpose, one of these commenters recommended defining an investment manager as someone who is either (i) included in a listing of investment managers with the Securities and Exchange Commission (SEC), (ii) in the business of providing investment advice for compensation and manages at least \$150 million in client assets, or (iii) has filed a Form D notice with the SEC with respect to the partnership at issue indicating that interests in such partnership are offered under an exemption from SEC registration requirements. Finally, one commenter provided a general list of facts and circumstances that should be considered when determining whether a partnership interest is a QPI, such as whether the exempt organization is a limited partner, whether the exempt organization has the right to be involved in the day-to-day management or operations of the partnership, and whether the exempt organization formed the partnership.

As noted in Notice 2018-67, the purpose of permitting the aggregation of QPIs is to reduce the administrative burden of obtaining information from the partnership regarding the trade or business activities of the partnership in which the exempt organization holds a modest interest, and particularly of lower-tier partnerships under such partnership. As stated in the preamble to the proposed regulations, the percentage interest level for QPIs was intended as a proxy to identify partnership interests in which the exempt organization does not significantly participate. 85 FR at 23180. Taking into account the comments received, the Treasury Department and the IRS have determined that, for purposes of section 512(a)(6), if the percentage interest level indicates that an exempt organization does not significantly participate in a partnership, the exempt organization is not likely to be able to easily obtain the information required to identify the trades or businesses conducted, directly or indirectly, by the partnership that are unrelated trades or businesses with respect to the exempt organization partner.

The recommendations of the commenters regarding alternate or additional meth-

³ See sections 512(c), 513(a); §1.513-1(d)(1) and (2); *Plumstead Theatre Society, Inc. v. Commissioner*, 74 T.C. 1324 (1980); 675 F.2d 244 (9th Cir. 1995); *Service Bolt & Nut Co. Profit Sharing Trust v. Commissioner*, 724 F.2d 519 (6th Cir. 1983), *affg.*, 78 T.C. 812 (1982); Rev. Rul. 98-15, 1998-1 C.B. 718.

ods to determine whether a partnership interest is a QPI do not provide administrable methods for proximately measuring an exempt organization's ability to obtain information about the partnership's trades or businesses. Under GAAP, an exempt organization accounts for a partnership interest using "fair value" if it does not control a partnership or have "significant influence" in the partnership or if it holds an interest the value of which is "readily determinable." FASB, 2020, ASC par. 958-810-15-4. As discussed in more detail in part 2.b.iv.B of this Summary of Comments and Explanation of Revisions, determining "significant influence" under GAAP is substantially similar to determining significant participation under the participation test. By FASB's own admission, however, determining significant influence is not always clear. FASB, 2020, ASC par. 323-10-15-7. Further, whether a partnership interest has a readily determinable value does not indicate whether an exempt organization has access to the information needed to identify trades or businesses conducted by the partnership that are unrelated trades or businesses with respect to the exempt organization partner. The de minimis and control tests provide a substantially similar standard to that found in GAAP that is more objective and that does not include additional factors outside the scope of the QPI test. Additionally, unlike the adoption of NAICS 2-digit codes, adopting GAAP would mean using a set of rules that are maintained and amended frequently by a non-governmental third party. Furthermore, GAAP does not always align with tax standards.

Similarly, the presence of an investment manager does not indicate whether an exempt organization can obtain information to identify separate unrelated trades or businesses conducted by a partnership. In addition, the requirements for being an investment manager, as outlined by the commenter, require reliance on an SEC system that is designed for purposes that do not align with those of the QPI tests. As a result, the investment manager test does not satisfy the purpose of the QPI tests and the Treasury Department and the IRS do not adopt this suggestion. Finally, the facts and circumstances test suggested by commenters relies on factors that do not tend to relate to the exempt organization's

ability to obtain the information from the partnership needed to identify separate unrelated trades or businesses and therefore do not advance the administrative convenience purpose of the QPI test. Accordingly, the Treasury Department and the IRS do not adopt these suggestions as a reliable method for identifying QPIs.

Other commenters suggested the inclusion of all limited partnerships or limited liability companies (LLCs) in which the exempt organization is not a general partner or managing member (regardless of the exempt organization's percentage interest or other participation in the partnership) as QPIs. As discussed in the preamble to the proposed regulations, the Treasury Department and the IRS decline to adopt this standard because of the variation in state law for determining non-managing member equivalent interests and the administrative burden that reliance on state law places on the IRS.

Accordingly, the Treasury Department and the IRS do not adopt the recommended alternative or additional methods for identifying a QPI.

i. Designation of a QPI

The proposed regulations provided that, once an organization designates a partnership interest as a QPI (in accordance with forms and instructions), it cannot thereafter identify the trades or businesses conducted by the partnership that are unrelated trades or businesses with respect to the exempt organization using NAICS 2-digit codes unless and until the partnership interest is no longer a QPI. For example, if an exempt organization has a partnership interest that is a QPI and the exempt organization designates that partnership interest as a QPI on its Form 990-T, the exempt organization cannot, in the next taxable year, identify the trades or businesses of the partnership that are unrelated trades or businesses with respect to the exempt organization using NAICS 2-digit codes. However, if, in a future taxable year, the exempt organization's partnership interest is no longer a QPI, then the exempt organization would be required to identify the trades or businesses of the partnership that are unrelated trades or businesses with respect to the exempt organization using NAICS 2-digit codes. No comments were

received regarding this provision. Accordingly, the final regulations adopt the proposed regulations regarding the designation of QPIs without change.

ii. General Partner Prohibition

The proposed regulations clarified that any partnership in which an exempt organization is a general partner is not a QPI, regardless of the exempt organization's percentage interest. One commenter noted that, while related parties are considered for determination of the percentage interest prong of the control test, these same related parties are not considered when determining the general partner status of the exempt organization under the de minimis test or for determining control under the second prong of the control test. Thus, a related entity may be a general partner in or may control the partnership in which an exempt organization has an interest and such control by the related party would not affect the outcome under the proposed regulations.

The Treasury Department and the IRS agree with the commenter that the determination of whether an exempt organization is a general partner should include related organizations. Thus, the final regulations clarify that, if an organization the interest of which must be taken into account when determining the exempt organization's percentage interest for purposes of the first prong of the control test is a general partner in a partnership in which an exempt organization holds an interest, then such interest is not a QPI.

One commenter recommended that the per se prohibition against general partner status for a partnership interest to be a QPI should be extended to status as a managing member of a limited liability company (LLC). The Treasury Department and the IRS agree that the term "partnership" includes all entities, including LLCs, treated as partnerships for Federal tax purposes. Accordingly, an interest in an LLC treated as a partnership for Federal tax purposes can be a QPI. However, the rule in the proposed regulations precluding a general partner interest from being a QPI was intended to apply only to interests held by partners classified as general partners under applicable state law. The Treasury Department and the IRS do not believe it

is appropriate to expand the per se prohibition to persons classified as managing members under applicable state law without the opportunity for further notice and comment, although managing members are unlikely to satisfy the participation test due to their significant participation in the LLC. Accordingly, the final regulations adopt the proposed regulation with the clarification that general partner status is determined under applicable state law.

iii. De Minimis Test

The proposed regulations provided that a partnership interest is a QPI that meets the requirements of the de minimis test if the exempt organization holds directly or indirectly no more than 2 percent of the profits interest and no more than 2 percent of the capital interest.

One commenter recommended removing the de minimis test. The Treasury Department and the IRS have concluded that the de minimis test reduces administrative burden by establishing a clear limit below which no other factors need to be considered for inclusion of such interest as a part of an exempt organization's investment activities. Therefore, the Treasury Department and the IRS retain the de minimis test in the final regulations.

One commenter recommended that the percentage interest threshold of the de minimis test should be increased to 5 percent consistent with other sections of the Code and regulations. The commenter notes that, not only have other parts of the Code determined that 5 percent is sufficiently de minimis, but also that increasing the amount from 2 percent to 5 percent would reduce administrative burden by potentially increasing the number of partnership interests that would meet the requirements of the de minimis test.

The Treasury Department and the IRS do not adopt this commenter's suggestion for the following reasons. For purposes of administrative convenience, the de minimis test allows certain partnership investments to be treated as an investment activity and aggregated with other investment activities. Otherwise, as previously discussed in this section of the preamble, section 512(c) mandates that any partnership interest, even a de minimis interest, must be analyzed to determine whether it is an

unrelated trade or business with respect to the exempt organization partner and, by extension, how many unrelated trades or businesses for purposes of section 512(a)(6). Accordingly, any exception made in the interest of the administrative convenience of taxpayers must be narrowly tailored to achieving that purpose.

Furthermore, under the control test, partnership interests that exceed 2 percent are QPIs if those interests meet the requirements of the control test (now renamed the participation test, as discussed in part 2.b.iv of this Summary of Comments and Explanation of Revisions). Many exempt organizations with partnership interests between 2 percent and 5 percent should be able to determine, without much additional burden, that they do not significantly participate in the partnership and thus the partnership interest is a QPI; thus, not much additional convenience would be gained for exempt organizations by increasing the de minimis percentage amount from 2 percent to 5 percent. On the other hand, increasing the percentage under which an exempt organization does not have to demonstrate a lack of significant participation to be able to treat the partnership interest as a QPI would extend the administrative convenience exception to identifying the separate unrelated trades or businesses of the partnership (in accord with section 513(c)) farther than necessary and undermine the statutory requirement of section 512(a)(6). Therefore, the final regulations follow the proposed regulations and provide that a partnership interest is a QPI that meets the requirements of the de minimis test if the exempt organization holds, directly or indirectly, no more than 2 percent of the profits interest and no more than 2 percent of the capital interest. Additionally, the final regulations clarify that the exempt organization must meet the percentage interest requirement of the de minimis rule during the exempt organization's taxable year with which or in which the partnership's taxable year ends.

iv. Control Test Renamed the "Participation Test"

The proposed regulations provided that a partnership interest is a QPI that meets the requirements of the control test if the

exempt organization (i) directly holds no more than 20 percent of the capital interest; and (ii) does not have control over the partnership. As previously discussed in this section, the QPI tests focus on determining whether an exempt organization significantly participates in a partnership, thereby indicating an ability to obtain the information needed from the partnership to determine whether a trade or business conducted by the partnership is an unrelated trade or business with respect to the exempt organization partner. To better reflect this intent, the control test has been renamed in these final regulations as the "participation test." Accordingly, the final regulations modify the participation test so that a partnership interest is a QPI that meets the requirements of the participation test if the exempt organization (i) directly holds no more than 20 percent of the capital interest; and (ii) does not significantly participate in the partnership.

A. Percentage Interest

Numerous commenters made recommendations regarding the first prong of the control test, most of which recommended increasing the percentage threshold to 50 percent to conform with the definition of control in section 512(b)(13). These commenters noted that the 50 percent threshold for capital interest is more in line with other definitions of control found in the Code. Other commenters suggested that the percentage interest requirement be eliminated entirely because an exempt organization may control a partnership regardless of its percentage interest.

The final regulations retain the 20 percent threshold used in the proposed regulations. As explained in the preamble to the proposed regulations, the percentage interest prong of the control test was intended to identify partnership interests in which the exempt organization does not have the ability to significantly participate in any partnership trade or business and therefore may be considered an investment activity for purposes of section 512(a)(6). Although an exempt organization may not significantly participate in a partnership in which it has more than a 20 percent interest, the Treasury Department and the IRS note that, as an exempt organization's percentage interest in a partnership increas-

es, so too does the exempt organization's ability to obtain the information necessary to identify the trades or businesses conducted by the partnership that are separate unrelated trades or businesses with respect to the exempt organization partner. Thus, the Treasury Department and the IRS have determined that, for purposes of this aspect of the administrative exception for investment activities, a 20 percent capital interest is a threshold below which the exempt organization may not be able to obtain the needed information if it does not otherwise significantly participate.

The preamble to the proposed regulations noted that the 20 percent threshold is consistent with the administrative exception found in the regulations under section 731 for certain investment activities. *See* section 731(c)(3)(C)(i) & §1.731-2(e). Some commenters noted that this was not a relevant standard because section 731(c)(3)(C)(i) does not define control. Section 731 defines investment partnerships, in part, as any partnership that has never been engaged in a trade or business.

The regulations under section 731(c)(3)(C)(i) identify situations in which the trade or business activities of a lower tier partnership should not be attributed to an upper tier partnership for purposes of determining whether the upper tier partnership is engaged in a trade or business. Similarly, the QPI rules in the proposed regulations seek to determine when the trade or business of a partnership should not be attributed to the exempt organization such that the partnership may be counted as part of an investment activity rather than as the participation in any underlying trade or business. Thus, the purpose of the regulations under section 731 and the QPI rules in the proposed regulations is similar.

The 20 percent capital interest threshold is further supported by the GAAP standard for "significant influence" that some commenters recommended as an alternative to the de minimis and participation tests (see parts 2.b.iii and 2.b.iv of this Summary of Comments and Explanation of Revisions). Due to the difficulty of the significant influence determination, GAAP provides that holding 20 percent

voting stock in an investee is presumed, without more, to constitute a significant influence. FASB, 2020, ASC par. 323-10-15-8. The 20 percent voting stock standard in GAAP was written for determining whether the investor has "significant influence" in a corporation. FASB, 2020, ASC par. 323-10-15-5. For tax purposes, it is common in the Code, when applying corporate standards to partnerships, to substitute "capital interest" for "voting stock." *See e.g.* sections 4943(c)(3), 6166(b), & 6038(e)(3). Thus, the 20 percent capital interest threshold in the proposed regulations is consistent with FASB's determinations of the percentage interest that represents "significant influence," which is similar to the significant participation standard found in these regulations.

Accordingly, the final regulations retain the 20 percent capital interest threshold provided by the proposed regulations but clarify that the exempt organization must meet the percentage interest requirement for the exempt organization's taxable year with which or in which the partnership's taxable year ends.

No comments were received regarding how an exempt organization determines its percentage interest in a partnership. Therefore, consistent with the proposed regulations and for purposes of both the de minimis test and the participation test, the final regulations continue to provide that an exempt organization determines its percentage interest by taking the average of the exempt organization's percentage interest at the beginning and the end of the partnership's taxable year, or, in the case of a partnership interest held for less than a year, the percentage interest held at the beginning and end of the period of ownership within the partnership's taxable year. However, the final regulations clarify that, for purposes of the de minimis test, an exempt organization's profits interest in a partnership is determined in the same manner as its distributive share of partnership taxable income (see section 704(b) relating to the determination of the distributive share by the income or loss ratio, and §§1.704-1 through 1.704-4). For purposes of both the de minimis test and the participation test the final reg-

ulations provide that, in the absence of a provision in the partnership agreement, an exempt organization's capital interest in a partnership is determined on the basis of its interest in the assets of the partnership which would be distributable to such organization upon its withdrawal from the partnership, or upon liquidation of the partnership, whichever is the greater.⁴

B. Definition of "Significant Participation"

Under the proposed regulations, a partnership interest met the requirements of the control test if the exempt organization holds no more than a 20 percent of the capital interest and does not control the partnership. The proposed regulations provided that all the facts and circumstances are relevant for determining whether an exempt organization controls a partnership. The proposed regulations clarified that the partnership agreement is among the facts and circumstances that may be considered when determining control. The proposed regulations also listed four specific circumstances that evidence control. Two of the circumstances focused on the exempt organization's ability to perform certain actions on its own. Specifically, the proposed regulations provided that an exempt organization controls a partnership if the exempt organization, by itself, may require the partnership to perform, or may prevent the partnership from performing, any act that significantly affects the operations of the partnership or has the power to appoint or remove any of the partnership's officers or employees or a majority of directors. The remaining two circumstances focused on whether any of the exempt organization's officers, directors, trustees, or employees have rights to participate in the management of the partnership at any time or to conduct the partnership's business at any time.

In essence, the proposed regulations provided a two-part test for determining control: (1) a general facts and circumstances test based on the well-defined concept in the Code of "control," and (2) factors evidencing "per se" control. As discussed in the introduction to part

⁴These clarifying rules for determining an exempt organization's partnership interest are consistent with longstanding rules in §53.4943-3(c)(2) for purposes of a private foundation's determination of whether it has excess business holdings.

2.b.iv of this Summary of Comments and Explanation of Revisions, the Treasury Department and the IRS have renamed the “control test” the “participation test” to better capture the purpose of the test, which is to identify partnerships in which exempt organization partners significantly participate. However, unlike “control,” “significant participation” generally is not a defined term in the Code. A test considering all the facts and circumstances to determine whether an exempt organization partner significantly participates in a partnership could have a broader application than intended. Furthermore, a general facts and circumstances standard for a test that is not well-defined increases uncertainty and, as a result, the administrative burden on exempt organizations and the IRS. Therefore, the final regulations do not include a general facts and circumstances test as part of the significant participation prong of the participation test, but instead retain only the four factors, which, in the final regulations, evidence significant participation rather than control.

Some commenters stated that the list of factors indicating control was too broad. One commenter contended that the factors focusing on whether an officer, director, or employee of an exempt organization has rights to manage the partnership or conduct the business of the partnership should be removed entirely as the presence of these factors does not indicate control by the exempt organization. While the factors identified by this commenter and the factors other commenters characterized as too broad may not always represent control, these factors do indicate when an exempt organization participates in the partnership to an extent that would allow the exempt organization to obtain sufficient information to identify the underlying separate trades or businesses.

Another commenter suggested that the factors listed as indicating control may not always result in control, and thus, the factors listed should create a rebuttable presumption of control rather than being “per se” indicators of control. The Treasury Department and the IRS retain the factors listed in the proposed regulations as “per se” indicators of significant participation because the QPI rules, including the participation test, are designed to provide administrative convenience for both the IRS

and exempt organizations. In this way, firm standards that indicate significant participation allow both the IRS and exempt organizations to have more certainty in the decision whether to include such interests with an exempt organization’s investment activities. A rebuttable presumption would introduce more uncertainty, rely more on facts and circumstances, and be more difficult for both the IRS and exempt organizations to administer.

The Treasury Department and the IRS note that the factors provided in the regulations are similar to the factors indicating “control” and “significant influence” under FASB’s codification of GAAP, which several commenters proposed as an alternative test. For partnership interests, GAAP determines that enough control exists to require the consolidation of partnership interests with the investor if the investor has substantive kick-out or participating rights. A kick-out right is the ability of limited partners to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause. FASB, 2020, ASC section 958-810-20. These rights are included, in the proposed regulations, in an exempt organization’s ability to require, by itself, the partnership to perform, or prevent the partnership from performing, any act that significantly affects the operations of the partnership.

Further, under GAAP, certain participating rights are considered per se substantive rights and overcome the presumption of control by a general partner. These include:

- Selecting, terminating, and setting the compensation of management responsible for implementing the limited partnership policies and procedures; and
- Establishing operating and capital decisions of the limited partnership, including budgets, in the ordinary course of business. ASC paragraph 958-810-25-22.

These substantive participating rights are similar to an exempt organization’s ability to appoint or remove, by itself, any of the partnership’s officers or employees or a majority of directors; or its officers, directors, trustees, or employees’ rights to conduct the partnership’s business at any time, respectively. As such, these substan-

tive participating rights found in GAAP are covered by the four factors listed in the proposed regulations as indicating control (here renamed significant participation).

Additionally, some of the factors relevant to “significant influence” included in GAAP are representation on the board, the ability to participate in the policy-making process, and the interchange of managerial personnel. FASB, 2020, ASC par. 323-10-15-6. These factors are also similar to the factors in the proposed regulations, which focus on whether an exempt organization’s officers, directors, trustees, or employees have rights to participate on the partnership’s board or participate in management of the business. Moreover, the ability to participate in the policy-making process could stem from the investor’s ability to require the partnership to perform, or prevent the partnership from performing, any act that significantly affects the operations of the partnership. Consequently, the factors for determining “significant influence” under GAAP are also covered by the factors listed in the proposed regulations.

Accordingly, the Treasury Department and the IRS have concluded that the list of factors indicating significant participation (renamed from “control” as used in the proposed regulations) is consistent with other standards recommended by commenters for making similar determinations. Therefore, the Treasury Department and the IRS continue to believe that, for purposes of the administrative exception for investment activities, the factors listed in the proposed regulations appropriately identify partnerships in which the exempt organization significantly participates such that it can obtain the information needed to identify the trades or businesses conducted by the partnership that are separate unrelated trades or businesses with respect to the exempt organization.

Commenters pointed out that the exercise of certain rights common to all partners in a partnership may be construed to come within the ambit of the list of factors indicating significant participation. Specifically, these commenters explained that an exempt organization with voting rights equal to those of a large number of other limited partners might be considered to be able to prevent the actions of a partnership if the vote requires a unanimous vote. The

Treasury Department and the IRS agree with these commenters that the ability to prevent an action of the partnership due to a unanimous vote requirement or through minority consent rights was not intended to be covered by the proposed regulations. Accordingly, the final regulations modify the proposed regulations' treatment of the ability of an exempt organization, by itself, to prevent a partnership from performing an act as a factor that indicates significant participation. As modified, the final regulations provide that an exempt organization significantly participates in a partnership if—

- The exempt organization, by itself, may require the partnership to perform, or prevent the partnership from performing (other than through a unanimous voting requirement or through minority consent rights), any act that significantly affects the operations of the partnership;
- Any of the exempt organization's officers, directors, trustees, or employees have rights to participate in the management of the partnership at any time;
- Any of the organization's officers, directors, trustees, or employees have rights to conduct the partnership's business at any time; or
- The organization, by itself, has the power to appoint or remove any of the partnership's officers or employees or a majority of directors.

Some commenters recommended that instead of, or in addition to, a list of factors that indicate significant participation, the regulations should provide a list of powers that do not indicate significant participation, such as the ability to remove or replace a fund manager who manages partnership investments, to approve the selection or removal of a general partner, to appoint a member of an advisory board of the partnership, to withdraw from a partnership, or to dissolve or terminate the partnership.

The Treasury Department and the IRS expect that, because the participation test no longer includes a general facts and circumstances test, the need to define actions that do not evidence significant participation is significantly reduced or eliminated. An exempt organization need not consider rights or powers other than the four specif-

ically listed in the participation test when determining whether a partnership interest is a QPI. Accordingly, the Treasury Department and the IRS decline to adopt the suggestion to include a list of powers that do not indicate significant participation.

C. Combining Related Interests

The proposed regulations provided a rule to address situations in which an exempt organization may control a partnership through the aggregation of interests (aggregation rule). The aggregation rule in the proposed regulations applied only for purposes of the control test and not for purposes of the de minimis test. The aggregation rule in the proposed regulations required an exempt organization to consider the interests of supporting organizations (as defined in section 509(a)(3)) and controlled entities (as defined in section 512(b)(13)) in the same partnership. The preamble to the proposed regulations stated that the Treasury Department and the IRS would continue to consider whether the aggregation of the interests of supporting organizations is appropriate in the circumstance in which the exempt organization is a supported organization that has little to no control over its supporting organizations.

A supporting organization is characterized as a Type I, Type II, or Type III supporting organization depending on its relationship with its supported organization. The supporting organization may be (i) operated, supervised, or controlled by (Type I), (ii) supervised or controlled in connection with (Type II), or (iii) operated in connection with (Type III), its supported organization.

For a Type I relationship to exist, a supported organization must have a substantial degree of direction over the policies, programs, and activities of its supporting organization. The relationship of the supported organization to the Type I supporting organization is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization.

For a Type II relationship to exist, there must be common supervision or control by the persons supervising or controlling both the supporting organization and the

publicly supported organizations to ensure that the supporting organization will be responsive to the needs and requirements of the publicly supported organizations. The relationship of the supported organization to the Type II supporting organization is comparable to that of a brother and sister, where the supporting organization and the supported organization are subject to common control. *Polm Family Foundation, Inc. v. United States*, 655 F. Supp. 2d 125, 128 (D.C. Cir. 2009) (quoting *Cocke Memorial Fund v. Commissioner*, 86 T.C. 53, 59 (1986)).

For a Type III relationship to exist, a supporting organization must, among other things, maintain significant involvement in the operations of a supported organization or provide support on which the supported organization is dependent. A Type III supporting organization can either be functionally integrated or non-functionally integrated. A functionally integrated Type III supporting organization can support its supported organization through engaging in activities substantially all of which directly further the exempt purposes of the supported organization, being the parent of the supported organization, or by supporting certain types of governmental supported organizations. A functionally integrated Type III supporting organization is a parent of the 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 capacity) of the supporting organization. A non-functionally integrated Type III supporting organization provides financial support to the supported organization that meets the distribution requirements found in §1.509(a)-4(i)(5)(ii).

Two commenters addressed whether partnership interests of related supporting organizations should be considered in determining the supported organization's percentage interest for purposes of determining whether the supported organization meets the control test. One commenter recommended that none of the partnership interests of a supporting orga-

nization should be considered when determining the supported organization's percentage interest. Another made the same recommendation but only with respect to Type III supporting organizations.

An exempt organization with more than one unrelated trade or business may be a supporting organization or a supported organization. If the exempt organization is a supported organization, the exempt organization, or individuals that control the exempt organization, may control the investment activities (including any partnership interests) of its Type I or Type II supporting organizations due to the parent/subsidiary relationship required for a Type I relationship to exist or the brother/sister relationship required for a Type II relationship to exist. In any event, these close relationships increase the likelihood that the exempt organization can obtain the information about its Type I or Type II supporting organization's partnership investments and that the exempt organization significantly participates in the partnership, even if indirectly. Accordingly, the final regulations continue to require an exempt organization that is a supported organization to include the partnership interests of its Type I or II supporting organizations when determining whether its partnership interests meet the percentage interest threshold of the participation test.

On the other hand, in the case of a Type III supporting organization, the exempt organization that is a supported organization is required to have a "significant voice" in the investment policies of its Type III supporting organization; nevertheless, depending on the basis for this Type III relationship, this relationship may not permit the supported organization to obtain detailed information regarding its Type III supporting organization's partnership interests or to significantly participate in the partnership. In the case of a Type III supporting organization that is the parent of its supported organizations, the relationship between the supported and supporting organizations is similar to that of a Type I supporting organization, except the supporting organization controls the supported organizations instead of the opposite. Due to this close relationship, the final regulations continue to require the aggregation of partnership interests held

by a Type III supporting organization that is the parent of its supported organizations for the purposes of determining whether the supported organization's partnership interest meets the percentage interest threshold of the participation test. However, the interests held by nonparent Type III supporting organizations are not so aggregated.

One commenter recommended adding additional interests to the list of related interests that must be considered when determining percentage interest for purposes of the control test. This commenter recommended including related persons within the definition of section 267(b) (9) and "controlled taxpayers" within the principles of section 482 to the list of organizations with which partnership interests must be aggregated. The same commenter also recommended adding indirect interests owned by an exempt organization for the purposes of determining the organization's percentage interest.

As mentioned previously, the QPI rules were created to reduce the administrative burden of obtaining the information needed to determine whether trades or businesses conducted – directly or indirectly – by the partnership are separate unrelated trades or businesses with respect to the exempt organization partner. The addition of the interests recommended to be included by this commenter would significantly increase the administrative burden of the rule but would not necessarily capture interests that demonstrate an increased ability for the exempt organization to obtain the information needed to identify separate underlying trades or businesses. Accordingly, the Treasury Department and the IRS do not adopt these recommended additions to the aggregation rule. The final regulations provide that, when determining an organization's percentage interest for purposes of the participation test (formerly the control test), the interests of a supporting organization (other than a Type III supporting organization that is not a parent of its supported organizations) or a controlled entity in the same partnership are taken into account.

v. Look-Through Rule

The proposed regulations provided that, if an exempt organization does not

control a partnership in which the exempt organization holds a direct interest (directly-held partnership interest) but the directly-held partnership interest is not a QPI because the exempt organization holds more than 20 percent of the capital interest, any partnership in which the exempt organization holds an indirect interest through the directly-held partnership interest (indirectly-held partnership interest) may be a QPI if the indirectly-held partnership interest meets the requirements of the de minimis test (look-through rule). Accordingly, the proposed regulations permitted (but did not require) an exempt organization to aggregate the UBTI from de minimis indirectly-held QPIs with its directly-held QPIs. However, the proposed look-through rule did not apply to indirectly-held QPIs that do not meet the requirements of the de minimis test but might meet the requirements of the control test (now renamed participation test).

Several commenters recommended expanding the look-through rule to permit use of the control test for indirectly-held partnership interests and to permit use of the look-through rule even if the exempt organization controls the directly-held partnership. These commenters stated that, even if an exempt organization controls a directly-held partnership, if the lower-tier partnerships meet the de minimis test or the control test, an exempt organization would be prevented from controlling the lower-tier partnerships. Further, the commenters noted that, preventing the use of such look-through rules would treat organizations holding the same level and type of partnership interests differently depending on whether they owned them directly or indirectly. Another commenter, however, stated that the look-through rule is unhelpful and that it is extremely difficult, if not impossible, to determine ownership percentages in lower-tier partnerships, especially multiple tiers down.

Based on these comments, the final regulations do not prevent application of the look-through rule if the exempt organization significantly participates in the directly-held partnership. The final regulations otherwise retain the look-through rule for indirectly-held partnership interests that meet the requirements of the de minimis test with regard to the exempt organization. Additionally, the final regulations ex-

pand application of the look-through rule to indirectly-held partnership interests that meet the requirements of the participation test with regards to the immediately higher-tier partnership that owns the interest in that partnership. Thus, for purposes of the look-through rule, the participation test will apply tier-by-tier to the exempt organization's indirectly-held partnership interests. The regulations explain how the second prong of the participation test — the significant participation prong — applies within this context and provides an example of the application of this test.

vi. Grace Period

The preamble to the proposed regulations stated that the Treasury Department and the IRS recognize that an exempt organization may not be aware of changes in its partnership interest until it receives a Schedule K-1 (Form 1065) from the partnership at the end of the partnership's taxable year. In such a circumstance, it may be appropriate to permit a higher percentage interest in taxable years in which the increase in an exempt organization's percentage interest during a taxable year is the result of the actions of other partners. The Treasury Department and the IRS requested comments regarding whether a higher percentage interest should be permitted in taxable years in which the increase occurs as the result of the actions of other partners.

One commenter stated that private investment funds often admit limited partners in waves ("closings") over the course of several months at the beginning of the fund's term. Therefore, the commenter recommended a phase-in period that would provide that the percentage interest in a newly formed partnership not be considered for purposes of the control test until the end of the partnership's initial closing period (as long as that period is no later than 18 months following the exempt organization becoming a partner). The final regulations do not adopt an initial phase-in period because the aggregation of an exempt organization's investment activities, including QPIs, is a rule of administrative convenience and a phase-in rule would increase the complexity of the rule. Additionally, as discussed in part 2.b.iv.A of this Summary of Comments and Explanation of Revisions, the

final regulations adopt, without change, the rule that an exempt organization's percentage partnership interest is determined by averaging the exempt organization's percentage partnership interest at the beginning of the partnership's taxable year with its partnership percentage interest at the end of that same taxable year. Thus, an exempt organization's percentage interest may vary during a period but still meet the requirements of the participation test.

The commenter also recommended that an exempt organization be granted 90 days to reduce its interest in a partnership to the appropriate amount should its interest exceed that amount at the end of the year through the actions of other partners. Two other commenters recommended that an exempt organization should be permitted to count a partnership interest that exceeds the percentage interest threshold of the participation test due to the actions of other partners as a QPI for a period of time following that change in interest amount. One of the commenters recommended that such interests should be permitted to be QPIs through the end of the tax year in which it learns that the percentage interest exceeds the permitted threshold. The other commenter recommended that such interest should continue to be QPI through the later of (1) the end of the tax year immediately following the year an increase occurs through no fault of the exempt organization; or (2) 120 days after the date on which the "between "organization" and "partnership" so that the list reads "the later of (1) the end of the tax year immediately following the year an increase occurs through no fault of the exempt organization; or (2) 120 days after the date on which the partnership issues the Schedule K-1. partnership issues the Schedule K-1.

The Treasury Department and the IRS agree that a change in an exempt organization's percentage interest in a partnership that is due entirely to the actions of other partners may present significant difficulties for the exempt organization. Further, requiring such an interest to be removed from the exempt organization's investment activities in one year but potentially included as a QPI in the next would create further administrative difficulty. Accordingly, the final regulations adopt a grace period that permits a partnership interest to be treated as meeting the requirements of the de mini-

mis test or the participation test, respectively, in the exempt organization's prior taxable year if certain requirements are met.

The final regulations provide that a partnership interest that fails to meet the requirements of either the de minimis test or the participation test because of an increase in percentage interest in the organization's current taxable year may be treated as meeting the requirements of the test it met in the prior taxable year for the taxable year of the change if: (1) the partnership interest met the requirements of the de minimis test or participation test, respectively, in the organization's prior taxable year without application of the grace period; (2) the increase in percentage interest is due to the actions of one or more partners other than the exempt organization; and (3) in the case of a partnership interest that met the requirements of the participation test in the prior taxable year, the interest of the partner or partners that caused the increase in percentage interest described in (2) was not combined for the prior taxable year and is not combined for the taxable year of the change with the exempt organization's partnership interest under the rules discussed in part 2.b.iv.C of this Summary of Comments and Explanation of Revisions. An exempt organization can treat such interest as a QPI in the taxable year that such change occurs, but the exempt organization would need to reduce its percentage interest prior to the end of the following taxable year to meet the requirements of either the de minimis test or the participation test in that succeeding taxable year for the partnership interest to remain a QPI.

vii. Reliance on Schedule K-1 (Form 1065)

The proposed regulations provided that, when determining an exempt organization's percentage interest for purposes of the de minimis test or the control test (now renamed the participation test), the exempt organization may rely on the Schedule K-1 (Form 1065) it receives from the partnership if the form lists the exempt organization's percentage profits interest or its percentage capital interest, or both, at the beginning and end of the year. However, the proposed regulations clarified that the organization may not rely

on the form to the extent that any information about the organization's percentage interest is not specifically provided. For example, if the Schedule K-1 (Form 1065) an exempt organization receives from a partnership lists the organization's profits interest as "variable" but lists its percentage capital interest at the beginning and end of the year, the organization may rely on the form only with respect to its percentage capital interest. Generally, this information can be found in Part II, line J (partner's share of profit, loss, and capital), of Schedule K-1 (Form 1065). No comments were received with respect to reliance on the Schedule K-1 (Form 1065). Accordingly, the final regulations adopt these proposed regulations without change, other than minor edits for clarity.

Nonetheless, commenters made recommendations with respect to other aspects of the Schedule K-1 (Form 1065) and other partnership or S corporation forms. A few commenters recommended that updates be made to the regulations under section 6031 or on the forms and instructions of the Form 1065, "U.S. Return of Partnership Income," or Form 1120-S, "U.S. Income Tax Return for an S Corporation," including the respective Schedules K-1 provided to partners or S corporation shareholders. These commenters requested updates that would require partnerships to provide information to exempt organization partners (1) on the NAICS 2-digit codes of the underlying activity, (2) separately reporting debt-financed income, and (3) requiring a specific capital interest amount rather than stating "various." Alternatively, another commenter specifically recommended that partnerships not be required to provide the NAICS 2-digit code of the underlying activity.

Section 6031(d) provides that partnerships must provide exempt organization partners with such information as is necessary to enable each partner to compute its distributive share of partnership income or loss from such trade or business in accordance with section 512(a)(1). Following the passage of section 512(a)(6), exempt organization partners will need additional information to compute their UBTI from partnerships under section 512(a)(1). The Treasury Department and the IRS have concluded that the requirement found in section 6031(d) is sufficient

for requiring partnerships to provide this information. Accordingly, the Treasury Department and the IRS do not adopt any regulatory changes under section 6031 at this time. The IRS may amend the forms and instructions in the future, however.

viii. Additional Recommended Changes

A. Capital Account Threshold

One commenter recommended that a capital accounts threshold be added to the control test. The commenter recommended that the threshold be based on the average capital account amount throughout the year and that the threshold be \$500,000. A capital account threshold does not further the purposes of the QPI tests. A capital accounts threshold added to the control test provided by the proposed regulations (now renamed the participation test) is not an effective proxy for an exempt organization's ability to obtain information from a partnership because the size of a capital account has no correlation to a partner's ability to participate in a partnership. Further, capital accounts can be calculated under various standards, which would result in an inconsistent application of such a rule. Additionally, if the commenter's level of \$500,000 capital accounts were accepted, IRS data for the 2018 taxable year indicates that it would encompass over 75 percent of all partnerships held by exempt organizations. Such a threshold therefore likely would not serve as an additional limitation on the ability to use the participation test. Accordingly, the Treasury Department and the IRS do not adopt a capital accounts threshold as part of the participation test.

B. ERISA-Covered Trusts

One commenter recommended that QPI treatment be extended to all partnership interests held by trusts that are subject to the Employee Retirement Income Security Act of 1974, Public Law 93-406, 88 Stat. 829 (1974) (ERISA). The commenter stated that because the fiduciary duty and prohibited transaction rules under ERISA would make it difficult to operate a trade or business through the trust itself, or through an entity that is treated under ERISA as holding "plan assets" subject to ERISA, the primary source of UBTI for these plans is

investment vehicles that are taxed as partnerships. In addition, the fiduciary and prohibited transaction rules (and related penalties) create an incentive for the investment vehicles to limit the participation of ERISA plans. If 25 percent or more of the value of any class of equity interests in a private investment fund is held by benefit plan investors, the plan assets of a benefit plan investor will generally include not only the plan's investment, but also an undivided interest in each of the underlying assets of the investment fund. Anyone who exercises authority or control with respect to the disposition of plan assets or who provides investment advice with respect to those assets will be a fiduciary of the investing plan. *See* 29 CFR 2510.3-101. Many investment funds seek to avoid this status by limiting ERISA plan investment or qualifying for an exemption. The commenter posited that under the proposed regulations, significant administration would be required to separate investments between QPIs and other partnerships that may be subject to the look-through rule or NAICS codes, and in which the ultimate, bottom-tier investments are almost certainly under the 2 percent ownership threshold for the *de minimis* test.

To the extent that ERISA-covered trusts' interests in partnerships meet either the *de minimis* or the participation tests, then those interests will be treated as investment activities. To the extent that the partnership interests of ERISA-covered trusts do not meet the *de minimis* or the participation test, nothing about ERISA-covered trusts suggests that they are in greater need of the administrative convenience provided by such tests. Consequently, the Treasury Department and the IRS do not adopt this recommendation.

C. Anti-abuse Rule

One commenter noted that an exempt organization with a directly-held partnership interest in a partnership that is not a QPI (non-QPI partnership) could also have one or more indirectly-held partnership interests in that same partnership through interests that are QPIs (QPI partnerships), which would effectively permit the exempt organization to significantly participate in a partnership but structure its partnership interest such that most of the distributable

share of the partnership's income, losses, etc. would be aggregated with its other investment activities. The commenter recommended requiring an exempt organization receiving income through a QPI partnership that derives income from a non-QPI interest in the same partnership to segregate that income from the "investment activities" trade or business and report it separately for each underlying trade or business.

Under the situation described by the commenter, an exempt organization's indirectly-held partnership interest (through a QPI partnership) in the non-QPI partnership would necessarily be limited by the fact that the exempt organization may own no more than 20 percent of the QPI partnership and the exempt organization cannot control the QPI partnership; therefore it would be difficult, and perhaps unlikely, for an exempt organization to actively arrange such a scenario for the purposes of avoiding the application of section 512(a)(6). Further, the application of such rule would reduce the administrative convenience that these rules seek to achieve. Accordingly, the Treasury Department and the IRS do not adopt the recommendation.

The same commenter, noting that such a rule would reduce the administrative burden of the QPI rules, recommended the creation of an anti-abuse rule in the alternative. The Treasury Department and the IRS recognize that some situations, similar to the situation posited by the commenter or otherwise, may exist whereby an exempt organization may arrange partnership structures to avoid application of section 512(a)(6). It is always the case that, upon examination, the IRS may determine whether partnership interests are QPIs under the application of the law to the facts and characterize such interests accordingly. Therefore, the Treasury Department and the IRS do not consider a specific anti-abuse rule necessary for purposes of the QPI rules and the final regulations do not incorporate this comment.

c. Transition Rule

Both Notice 2018-67 and the proposed regulations permitted an exempt organization to treat each partnership interest acquired prior to August 21, 2018, that met the requirements of neither the de minimis test nor the control test, as one trade or

business for purposes of section 512(a)(6), regardless of whether there was more than one trade or business directly or indirectly conducted by the partnership or lower-tier partnerships (transition rule). This transition rule was proposed to apply until the first day of the organization's first taxable year beginning after the date the proposed regulations are published as final regulations (transition period). The proposed regulations clarified that a partnership interest acquired prior to August 21, 2018, will continue to meet the requirement of the transition rule even if the exempt organization's percentage interest changes on or after August 21, 2018. Further, the proposed regulations provided that an exempt organization may apply either the transition rule or the look-through rule, but not both, to a partnership interest that meets the requirements for both rules.

Three commenters recommended that the transition rule become a grandfather rule such that any partnership interest meeting the requirements of the transition rule would be a single unrelated trade or business in perpetuity for purposes of section 512(a)(6). One commenter stated that the rationale for the transition rule outlined in Notice 2018-67 that "[a] previously acquired partnership interest may be difficult to modify to the de minimis test or control test and the exempt organization may have to incur significant transaction costs to do so" will continue to be an accurate reflection of the difficulty of transitioning such previously owned partnership interests even after the final regulations are published.

Changing the transition rule to a grandfather rule is contrary to the congressional intent of section 512(a)(6) to prevent losses of one unrelated trade or business from offsetting gains of another unrelated trade or business. Exempt organizations have been on notice since the announcement of the transition rule in Notice 2018-67 that the transition rule would sunset after publication of final regulations and have had over two years since the release of Notice 2018-67 to anticipate the requirement to account for the income from such partnership interests differently. The Treasury Department and the IRS disagree that the rationale for the transition rule justifies perpetually excluding previously held partnership interests from the application

of section 512(a)(6) to the unrelated trade or business activities of the partnership. Accordingly, the Treasury Department and the IRS do not adopt the transition rule as a grandfather rule.

d. Unrelated Debt-Financed Income

The proposed regulations included unrelated debt-financed property or properties described in sections 512(b)(4) and 514 in the list of "investment activities" treated as a separate unrelated trade or business for purposes of section 512(a)(6). One commenter recommended that the reference to the definition of debt-financed property "within the meaning of section 514" exclude section 514(b)(1)(B) because that paragraph removes from the definition of debt-financed property any property that is used in the production of income from an unrelated trade or business and proposed §1.512(a)-6(c)(1)(iii) includes income from debt-financed property in the "investment activities trade or business." The commenter further recommended that "debt-financed property" exclude debt-financed property used in the production of income from an unrelated trade or business that is reported under a NAICS two-digit code by the exempt organization. Two other commenters recommended allowing exempt organizations to opt out of inclusion of debt-financed property as part of an exempt organization's investment activities and to instead include that income as part of a separate unrelated trade or business identified by the relevant NAICS 2-digit code.

Section 512(b)(4) includes as UBTI any unrelated debt-financed income as defined in section 514. As part of the definition of debt-financed property, section 514(b)(1)(B) provides that "any property [is not debt-financed property] to the extent that the income from such property is taken into account in computing the gross income of any unrelated trade or business" without application of section 512(b)(4). For example, if an exempt organization runs a hotel, but it has taken out a loan to acquire the hotel, then the income from the hotel is UBTI regardless of section 512(b)(4) and the hotel is not "debt-financed property." Sections 1.512(b)-1(c)(5) and 1.514(b)-1(b)(2)(ii). Thus, the income from the hotel is not "debt-financed

income.” As a result, any income included in UBTI as “debt-financed income” necessarily derives from an activity that has otherwise been excluded from the definition of UBTI in section 512(a)(1), for reasons other than the exempt nature of the activity. Section 514 taxes otherwise nontaxable income, derived from leveraged income-producing assets, that are not related to an organization’s exempt purposes. Debt-financed income is, therefore, of a different nature than income that is otherwise described in section 512(a)(1) and is more appropriately classified as investment rather than being tied to an underlying trade or business or NAICS 2-digit code.

Furthermore, allowing an exempt organization to elect to treat the debt-financed income as part of a NAICS 2-digit code, instead of including such income as part of an organization’s investment activities, would not reduce the burden on the exempt organization or the burden on the IRS. Such income would still need to be identified as debt-financed income and an additional determination of the underlying activity would also need to be made to determine a NAICS 2-digit code. Furthermore, the inconsistent treatment of debt-financed income by different exempt organizations would increase the administrative burden for the IRS.

Accordingly, the Treasury Department and the IRS adopt the proposed regulation regarding the treatment of debt-financed income without change.

3. S Corporation Interest Treated as an Interest in an Unrelated Trade or Business

For purposes of the unrelated business income tax, section 512(e) provides special rules applicable to S corporations. Section 512(e)(1)(A) provides that if an exempt organization permitted to be an S corporation shareholder (as described in section 1361(c)(2)(A)(vi) or (6)) holds stock in an S corporation, such interest will be treated as an interest in an unrelated trade or business. Thus, notwithstanding any other provision in sections 511 through 514, section 512(e)(1)(B) requires an exempt organization permitted to hold S corporation stock to take the following amounts into account in computing the

UBTI of such exempt organization: (i) all items of income, loss, or deduction taken into account under section 1366(a) (regarding the determination of an S corporation shareholder’s tax liability); and (ii) any gain or loss on the disposition of the stock in the S corporation.

a. Qualifying S Corporation Interests

As discussed in part 2.a.i of this Summary of Comments and Explanation of Revisions, the proposed and final regulations include qualifying S corporation interests (QSIs) in an exempt organization’s investment activities. The proposed regulations explained that an S corporation interest is a QSI if the exempt organization’s ownership interest (by percentage of stock ownership) in the S corporation meets the requirements for a QPI – that is, the requirements of either the de minimis test or the control test (now renamed the participation test).

The final regulations provide greater clarity regarding how the QPI rules apply to S corporation interests. First, the final regulations provide a number of term substitutions. Specifically, the final regulations provide that, when applying the QPI rules to an S corporation interest, “S corporation” is substituted for “partnership” and “shareholder” or “shareholders” is substituted for “partner” or “partners.” When applying the de minimis test, “no more than 2 percent of stock ownership” is substituted for “no more than 2 percent of the profits interest and no more than 2 percent of the capital interest” and, when applying the participation test, “no more than 20 percent of stock ownership” is substituted for “no more than 20 percent of the capital interest.” When applying the reliance rule, “Schedule K-1 (Form 1120-S)” is substituted for “Schedule K-1 (Form 1065).”

Second, the final regulations clarify that the rules regarding the determination of an exempt organization’s capital interest and profits interest in a partnership do not apply for purposes of determining whether an S corporation interest is a QSI. Rather, the average percentage stock ownership is determinative.

Third, because of differences in the Schedule K-1 (Form 1065) and the Schedule K-1 (Form 1120-S), the final regu-

lations clarify that an exempt organization can rely on the Schedule K-1 (Form 1120-S) received from the S corporation if the form lists information sufficient to determine the exempt organization’s percentage of stock ownership for the year. A Schedule K-1 (Form 1120-S) that reports “zero” as the organization’s number of shares of stock in either the beginning or end of the S corporation’s taxable year does not list information sufficient to determine the organization’s percentage of stock ownership for the year. The Treasury Department and the IRS are considering whether revision of Schedule K-1 (Form 1120-S) is necessary to provide the information needed to determine whether an S corporation interest is a QSI.

Finally, the final regulations also clarify that a grace period may apply for changes in an exempt organization’s percentage of stock ownership in an S corporation.

b. Nonqualifying S Corporation Interests

With the exception of QSIs, the proposed regulations applied the language of section 512(e)(1)(A) to provide that if an exempt organization owns stock in an S corporation, such S corporation interest will be treated as an interest in a separate unrelated trade or business for purposes of the proposed regulations. Similarly, the proposed regulations clarified that if an exempt organization owns two S corporation interests, neither of which is a QSI, the exempt organization will report two separate unrelated trades or businesses, one for each S corporation interest. The proposed regulations also provided that the UBTI from an S corporation interest is the amount described in section 512(e)(1)(B), which includes both the items of income, loss, or deduction taken into account under section 1366(a) and the gain or loss on the disposition of S corporation stock.

Two commenters recommended that an exempt organization with an S corporation interest should be permitted to look through that S corporation to the underlying trades or businesses and to classify those S corporation trades or business using NAICS 2-digit codes. One of these commenters suggested that this should be the general rule for all non-qualifying S corporation interests. The other comment-

er provided that such a rule should be an alternative to the rule requiring each S corporation interest to be treated as an interest in a separate unrelated trade or business. One of these commenters further recommended that income that would ordinarily be excluded under section 512(b)(1), (2), (3) or (5), but that is taxable because it is earned through an S corporation, should be included as part of the exempt organization's investment activities.

The final regulations adopt the proposed regulations regarding non-qualifying S corporation interests without change. As discussed in the preamble to the proposed regulations, this treatment is consistent with the language of section 512(e)(1)(A), which treats an interest in an S corporation as an unrelated trade or business. Although the Treasury Department and the IRS considered whether to permit exempt organizations to look through the S-corporation and identify the separate unrelated trades or businesses conducted by the S-corporation using NAICS 2-digit codes as a matter of administrative convenience, the commenters to Notice 2018-67 noted that obtaining that information from the S corporation would be difficult. Accordingly, the Treasury Department and the IRS decline to adopt a rule that modifies the straightforward application of the language of section 512(e)(1)(A) and is not otherwise justified as a matter of administrative convenience to taxpayers or the IRS.

4. Social Clubs, Voluntary Employees' Beneficiary Associations, and Supplemental Unemployment Benefits Trusts

As discussed in the preamble to the proposed regulations, section 512(a)(3) provides a special definition of UBTI for social clubs, VEBAs, and SUBs.⁵ Unlike an exempt organization subject to section 512(a)(1) which is taxed only on income derived from an unrelated trade or business, a social club, VEBA, or SUB is taxed on "gross income (excluding exempt function income)," which includes amounts excluded from the calculation of UBTI under section 512(a)(1), such as

interest, annuities, dividends, royalties, rents, and capital gains. The preamble to the proposed regulations provided that, despite the differences between section 512(a)(1) and (3), a social club, VEBA, or SUB would determine whether it has more than one unrelated trade or business in the same manner as an exempt organization subject to section 512(a)(1). The final regulations adopt the same approach, as discussed in parts 4.a and b of this Summary of Comments and Explanation of Revisions.

a. Investment Activities

As discussed in part 2 of this Summary of Comments and Explanation of Revisions, the proposed regulations treated certain investment activities (that is, QPIs, QSIs, and debt-financed property or properties) as a separate unrelated trade or business for purposes of section 512(a)(6). Thus, because a social club, VEBA, or SUB determines whether it has more than one unrelated trade or business in the same manner as an exempt organization subject to section 512(a)(1), such an exempt organization would include the investment activities specifically listed in the proposed regulations as a separate unrelated trade or business for purposes of section 512(a)(6). However, because UBTI is defined differently for social clubs, VEBAs, and SUBs, the proposed regulations clarified that, in addition to other investment activities treated as a separate unrelated trade or business for purposes of section 512(a)(6), gross income from the investment activities of a social club, VEBA, or SUB also includes any amount that (i) would be excluded from the calculation of UBTI under section 512(b)(1), (2), (3), or (5) (that is, interest, annuities, dividends, royalties, rents, and capital gains) if the organization were subject to section 512(a)(1); (ii) is attributable to income set aside (and not in excess of the set aside limit described in section 512(a)(3)(E)), but not used, for a purpose described in section 512(a)(3)(B) (i) or (ii); or (iii) is in excess of the set aside limit described in section 512(a)(3)(E). The final regulations adopt the proposed investment activity rules specific to

social clubs, VEBAs, and SUBs, without change as discussed in part 4.a.i and ii of this Summary of Comments and Explanation of Revisions.

In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on any unintended consequences, in areas other than UBIT, resulting from the treatment of investment activity of VEBAs and SUBs as an unrelated trade or business for purposes of section 512(a)(6). One commenter expressed a concern that these proposed rules could encourage VEBAs and SUBs to create more complicated investment structures (for example, increased use of blocker corporations) or that these rules could encourage VEBAs and SUBs to consider more conservative investment strategies than otherwise merited based on their asset values.

The commenter did not include any further elaboration on these general nontax concerns regarding the investment behavior of VEBAs and SUBs. Furthermore, the commenter did not offer a specific recommendation to address these general concerns other than its overall recommendation to not treat investment activities as an unrelated trade or business for purposes of section 512(a)(6). As discussed earlier in part 2 of this Summary of Comments and Explanation of Revisions, the Treasury Department and the IRS have concluded that the structure and purposes of sections 511 through 514 treat an exempt organization's investment activities as unrelated trade or business activities for purposes of section 512(a)(6). Accordingly, the final regulations adopt these provisions of the proposed regulations without change.

i. Amounts Described in Section 512(b)(1), (2), (3), and (5)

Social clubs, VEBAs, and SUBs generally must include interest, dividends, royalties, rents, and capital gains in UBTI under section 512(a)(3)(A) because the modifications in section 512(b)(1), (2), (3), and (5) are not available under section 512(a)(3). Nonetheless, such amounts may be excluded from UBTI if set aside (and not in excess of the set aside limit

⁵See §1.512(a)-5, 84 FR 67370 (Dec. 10, 2019), for a discussion of the UBTI rules as they specifically apply to VEBAs and SUBs.

described in section 512(a)(3)(E)) for a purpose described in section 512(a)(3)(B) (i) or (ii).⁶ Interest, dividends, royalties, rents, and capital gains generally are considered income from investment activities and, as stated in part 4 of this Summary of Comments and Explanation of Revisions, treated as one unrelated trade or business for purposes of section 512(a)(6). Accordingly, the proposed regulations provided that, for purposes of section 512(a)(6), UBTI from the investment activities of a social club, VEBA, or SUB includes any amount that would be excluded from the calculation of UBTI under section 512(b) (1), (2), (3), or (5) if the social club, VEBA, or SUB were subject to section 512(a)(1).

Commenters generally were in favor of this approach. Accordingly, the final regulations adopt this portion of the proposed regulations without change.

ii. Amounts Set Aside but Used for Another Purpose and Amounts in Excess of Account Limits

Section 512(a)(3)(B) provides that, if an amount which is attributable to income set aside for a purpose described in section 512(a)(3)(B)(i) or (ii) is used for a purpose other than one described therein, then such amount shall be included in UBTI under section 512(a)(3)(A). Furthermore, with respect to a VEBA or SUB, the amount set aside may not exceed the set aside limit under section 512(a)(3)(E) and any amount that exceeds this limit is UBTI under section 512(a)(3)(A).

As discussed in part 4.a.i of this Summary of Comments and Explanation of Revisions, the amounts that may be set aside under section 512(a)(3)(B)(i) or (ii) are income from the social club, VEBA, or SUB's investment activities. Therefore, the proposed regulations also provided that UBTI from the investment activities of a social club, VEBA, or SUB includes any amount that is attributable to income set aside (and not in excess of the set aside limit described in section 512(a)(3)(E)), but not used, for a purpose described in section 512(a)(3)(B)(i) or (ii) and also

includes any amount in excess of the set aside limit described in section 512(a)(3)(E).

No comments were received on this section of the proposed regulations and it is therefore adopted as final.

b. Social Club Activities

i. Limitation on Investment Activities

Section 501(c)(7) requires that "substantially all of the activities" of an organization described therein be "for pleasure, recreation, and other non-profitable purposes." Accordingly, a social club has specific limits on the amount of non-exempt function income that may be earned without endangering its tax-exempt status. While the Code does not provide more detail, intended limits are described in legislative history. *See* S. Rep. No. 94-1318 (1976), at 4-5. Additionally, Congress did not intend social clubs to receive, within these limits, non-traditional unrelated business income. *Id.* at 4 ("It is not intended that these organizations should be permitted to receive...income from the active conduct of businesses not traditionally carried on by these organizations."). Accordingly, consistent with Notice 2018-67, the proposed regulations provided that the QPI rule and the transition rule do not apply to social clubs because social clubs should not be invested in partnerships that would generally be conducting non-traditional, unrelated trades or businesses that generate more than a de minimis amount of UBTI. In this regard, a partnership interest meeting the requirements of the de minimis rule in these proposed regulations is not the same as a partnership interest generating only de minimis amounts of UBTI from non-traditional, unrelated trades or businesses.

One commenter recommended that social clubs should have access to the de minimis test for investments in partnerships. The commenter states that partnership holdings may include exclusively items that are described in section 512(b) (1), (2), (3), and (5) and that social clubs would have equal difficulty determining

the underlying trade or business as other exempt organization investors.

The Treasury Department and the IRS do not adopt the commenter's recommendation for the following reasons. To the extent that a social club is invested in a partnership all of the holdings of which would be excluded under section 512(b) (1), (2), (3), and (5) if the social club were subject to section 512(a)(1), then all such income is part of the social club's investment activities trade or business without application of the de minimis test. To the extent that a social club holds, directly or indirectly, an interest in a partnership that is performing a non-traditional, unrelated trade or business, then under section 512(c) the social club itself is engaged in a non-traditional, unrelated trade or business. Because a social club's non-traditional activities could jeopardize a social club's exemption, it is incumbent upon the social club to know the type and amount of such activities without regard to section 512(a)(6). Thus, the Treasury Department and the IRS do not consider the administrative convenience rationale supporting the QPI rule as relevant for social clubs and do not adopt the commenter's recommendation.

ii. Nonmember Activities

Under the proposed regulations, a social club with nonmember income is subject to the same rules for identifying its unrelated trades or businesses as an organization subject to the rules of section 512(a)(1). Further, as discussed in the preamble to the proposed regulations, a social club cannot use the NAICS 2-digit code generally describing golf courses and country clubs (71) to describe all its nonmember income because the NAICS code used must describe its separate unrelated trade or business and not the purpose for which it is exempt. While this code may describe some of a social club's nonmember income, such as greens fees, other NAICS codes may be more appropriate to describe other nonmember income, such as merchandise sales (45) and food and beverage services (72). Accordingly,

⁶As explained in the introduction to part 4 of this Summary of Comments and Explanation of Revisions, treating the investment activities of a social club, VEBA, or SUB as an unrelated trade or business for purposes of section 512(a)(6) does not affect the amounts that may be set aside under section 512(a)(3)(B)(i) or (ii).

a social club must identify its separate unrelated trades or businesses in accordance with the rule described in part 1 of this Summary of Comments and Explanation of Revisions, like an exempt organization subject to section 512(a)(1). See part 1.c of this Summary of Comments and Explanation of Revisions for a discussion of how to identify the appropriate NAICS 2-digit code.

Commenters again requested that a social club be permitted to treat all nonmember activities as one unrelated trade or business for purposes of section 512(a)(6). The commenters stated that separating a social club's nonmember activities into more than one unrelated trade or business would result in substantial administrative burden. The commenters described the variety of activities in which social clubs engage, including food and beverage sales in club dining facilities and on club grounds (such as at pools or on golf courses and tennis courts); retail sales; greens fees; and space rental fees, whether or not they include substantial services. One commenter also stated that, because the treatment of UBTI for social clubs under section 512(a)(3) is different from that of other exempt organizations' treatment of UBTI under section 512(a)(1), using different rules to identify the separate unrelated trades or businesses for social clubs was reasonable. Finally, a commenter provided that, because social clubs are already capped at 15 percent of their revenue from nonmember activities, aggregating all nonmember income under that cap has a de minimis effect on taxable income while greatly decreasing the administrative burden of such organizations.

Section 512(a)(3) taxes all income, other than exempt function income, of the exempt organizations subject to that section, while section 512(a)(1) taxes only the income from the unrelated trades or businesses of all other exempt organizations. As a result, section 512(a)(3) captures a broader group of sources of income than under section 512(a)(1). Further, Congress has previously expressed a desire to limit the nonmember income of a social club to 15 percent of all income and to constrain further the non-traditional trades or businesses of a social club. See S. Rep. No. 94-1318, at 4. Social clubs would be

in a more favorable tax position if social clubs were permitted to aggregate income that organizations subject to section 512(a)(1) would not be able to aggregate if they performed the same activities. The Treasury Department and the IRS are not persuaded that social clubs should have a more favorable position under section 512(a)(6) than other exempt organizations. Additionally, section 512(a)(6) does not specifically except social clubs, nor does it except a social club's nonmember income. Accordingly, the Treasury Department and the IRS do not adopt the recommendation to treat all of a social club's nonmember income as a single unrelated trade or business.

One commenter recommended that social clubs be permitted to use the Uniform System of Financial Reporting for Clubs that is produced jointly by the Hospitality Financial and Technology Professionals and the Club Managers Association of America. This commenter stated that this system would better represent separate unrelated trades or businesses historically identified by social clubs.

The accounting system recommended by the commenter is a proprietary system that is not available for public use. Adopting this system as the required method of identifying a separate unrelated trade or business for social clubs would require all such clubs to purchase the materials of a third-party provider. Accordingly, the Treasury Department and the IRS do not adopt the Uniform System of Financial Reporting for Clubs as a method of identifying a separate unrelated trade or business for social clubs.

The final regulations adopt the proposed regulations' treatment of a social club's nonmember activities without change.

iii. Nonrecurring Events

The Treasury Department and the IRS recognize that UBTI within the meaning of section 512(a)(3) includes gross income without regard to a specific determination regarding the associated activities' qualification as an unrelated trade or business (within the meaning of section 513) because UBTI under section 512(a)(3) includes "all gross income (excluding exempt function income)."

These final regulations generally require an exempt organization to identify its separate unrelated trades or businesses using the NAICS 2-digit code that most accurately describes each trade or business. Whether an infrequent or possibly nonrecurring event constitutes a separate unrelated trade or business or whether such event is part of another trade or business (including, in some cases, part of the social club's investment activities) depends on the facts and circumstances of each social club and the event at issue, including the scope of activities as part of the event. While such determination is not necessary for including such income in UBTI under section 512(a)(3), identification of separate unrelated trades or businesses is necessary for applying section 512(a)(6). In the preamble to the proposed regulations, the Treasury Department and the IRS requested comments regarding the particular facts and circumstances that should be considered by a social club when determining whether a non-recurring event should be treated as a separate unrelated trade or business, part of a larger trade or business, or as part of a social club's investment activities for purposes of section 512(a)(6).

Multiple commenters provided several facts and circumstances that might assist a social club in identifying the separate unrelated trade or business associated with the non-recurring activity. However, the Treasury Department and the IRS have determined that, due to the limited nature of these activities and the great variety of such circumstances, the inclusion of such a list of factors within the final regulations is not warranted at this time. Accordingly, the Treasury Department and the IRS do not adopt any additional factors for social clubs to consider when identifying the separate trade or business of the non-recurring activity. Social clubs can rely on the general rules in the final regulations for identifying a separate trade or business to identify the separate trade or business associated with non-recurring events.

iv. Activities Without a Profit Motive

As discussed in part 1 of this Summary of Comments and Explanation of Revisions, §1.513-1(b) provides that "for purposes of section 513 the term trade

or business has the same meaning it has in section 162, and generally includes any activity carried on for the production of income.” The requirement for a trade or business to have an intent to profit is further supported by case law. *See, e.g., Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987) (stating that, “to be engaged in a trade or business, ... the taxpayer’s primary purpose for engaging in the activity must be for income or profit”). This profit motive requirement was applied to the unrelated trades or businesses of a social club in *Portland Golf Club v. Commissioner*, 497 U.S. 154 (1990) (finding that, under section 512(a)(3) prior to the enactment of section 512(a)(6), the golf club could use nonmember sales losses for food and drink to offset investment income only if the sales were motivated by an intent to profit, and in demonstrating the requisite profit motive, the golf club had to employ the same method of allocating fixed expenses as it used in calculating its actual loss).

One commenter on the proposed regulations requested that the Treasury Department and the IRS clarify that nonmember activities conducted without intent to profit are not unrelated trades or businesses. In the preamble to the proposed regulations, the Treasury Department and the IRS declined to address this comment because it is adequately addressed by existing precedent and cited to *Portland Golf*.

In response to the preamble of the proposed regulations, one commenter stated that a specific trade or business activity must be identified prior to determining whether it creates losses on a consistent basis. Given that the trade or business activity must first be identified, and that the proposed regulations prescribed the use of NAICS 2-digit codes for identifying a separate unrelated trade or business, the commenter noted that a social club must first identify the appropriate NAICS 2-digit code for a trade or business activity and determine whether the trade or business activity represented by that NAICS 2-digit code generates losses on a consistent basis (and thus may lack the requisite profit motive to be a trade or business at all for UBIT purposes). Under this analysis, the commenter recommended allowing exempt organizations to include, or

exclude, certain activities from a trade or business based on the social club’s internal determination that the activity lacks a profit motive.

The Treasury Department and the IRS agree that profit motive is relevant to determining whether an activity is a trade or business and that an exempt organization has a separate unrelated trade or business for purposes of section 512(a)(6) only if the activity being analyzed as separate is a trade or business. The Treasury Department and the IRS also agree that, for UBIT purposes, the appropriate level for determining whether a profit motive exists (based on the generation of consistent losses) with regard to an activity as a trade or business is the NAICS 2-digit level since the Treasury Department and the IRS have determined that the NAICS 2-digit codes appropriately identify separate unrelated trades or businesses.

However, the Treasury Department and the IRS do not adopt the commenter’s recommendation to allow exempt organizations to exclude certain activities from the UBTI calculation based on the organization’s assertion of a lack of intention to make a profit. In determining the lack of a profit motive, greater weight is given to objective facts than to a taxpayer’s intent. *See, e.g.,* §1.183-2(a). Thus, an exempt organization would need to demonstrate a factual lack of profit motive rather than claiming a lack of intent without any demonstrated losses. Furthermore, in light of the purpose and effect of section 512(a)(6) to not permit losses from one trade or business to offset income from another trade or business, the commenter’s recommendation would only benefit exempt organizations if the exempt organization could exclude income from a trade or business activity (first separated on the basis of the NAICS 2-digit code levels) from UBTI on an assertion that the exempt organization has no profit motive with regard to such activity notwithstanding the income from that activity. The Treasury Department and the IRS do not see any basis for providing such a rule.

5. Total UBTI and the Charitable Contribution Deduction

Consistent with section 512(a)(6), the proposed regulations provided that the to-

tal UBTI of an exempt organization with more than one unrelated trade or business is the sum of the UBTI with respect to each separate unrelated trade or business, less the specific deduction under section 512(b)(12), and that the UBTI with respect to any separate unrelated trade or business cannot be less than zero.

Section 512(b)(10) and (11) permit exempt organizations to take a charitable contribution deduction. The amount of this deduction, in the case of section 512(b)(10), which applies to most exempt organizations, is limited to 10 percent of UBTI computed without application of the charitable contribution deduction and, in the case of section 512(b)(11), which applies to certain trusts, is limited to the amounts described in section 170(b)(1)(A) and (B) determined with reference to UBTI, again, computed without application of the charitable contribution deduction. The proposed regulations clarified that the term “unrelated business taxable income” as used in section 512(b)(10) and (11) refers to UBTI after application of section 512(a)(6). As a result, the limitations on the charitable contribution deduction would be computed using total UBTI under section 512(a)(6)(B).

Although the proposed regulations clarified how to calculate the limitation on the charitable contribution deduction (that is, using total UBTI), the proposed regulations did not explicitly state, other than in the preamble, that the charitable contribution deduction was to be taken against total UBTI. Accordingly, the final regulations have been revised to clarify that the total UBTI of an exempt organization with more than one unrelated trade or business is the sum of the UBTI with respect to each separate unrelated trade or business, less a charitable contribution deduction, an NOL deduction for losses arising in taxable years beginning before January 1, 2018 (discussed in part 6 of this Summary of Comments and Explanation of Revisions), and a specific deduction under section 512(b)(12), as applicable.

One commenter asserted that certain expenses, such as tax return preparation fees and state taxes, are difficult to allocate between two or more unrelated trades or businesses and recommended that exempt organizations be permitted to deduct

such expenses against total UBTI. Similarly, this commenter recommended that investment management fees be deducted against total investment related UBTI (instead of total UBTI). In support of this suggestion, this commenter noted that the proposed regulations permitted the charitable contribution deduction in section 512(b)(10) and (11) to be taken against total UBTI.

The final regulations do not adopt this commenter's recommendations. First, the charitable contribution deduction in section 512(b)(10) and (11) is distinguishable from other deductions under section 512(a)(1) or (3) or section 512(b) because the Code specifically provides that this deduction is permitted "whether or not directly connected with the carrying on of an unrelated trade or business." Accordingly, the Treasury Department and the IRS determined that the charitable contribution deduction could be taken against total UBTI calculated under section 512(a)(6) (B).

Second, the structure of section 512(a)(6) itself confirms that Congress did not intend for any deductions to be taken against total UBTI calculated under section 512(a)(6)(B) other than the ones specifically permitted. Section 512(a)(6)(A) provides that, when calculating the UBTI of a separate unrelated trade or business, such calculation is made "without regard to" the specific deduction in section 512(b)(12). Section 512(a)(6)(B) clarifies that total UBTI is the sum of UBTI computed with respect to each separate unrelated trade or business "less a specific deduction under [section] 512(b)(12)." Thus, the only deductions permitted against total UBTI are a charitable contribution deduction under section 512(b)(10) and (11), an NOL deduction for losses arising in taxable years beginning before January 1, 2018 (permitted by section 13702(b)(2) of the TCJA), and a specific deduction under section 512(b)(12). All other deductions are taken against the UBTI of each separate unrelated trade or business, provided that each such deduction meets the requirements of section 512(a)(1) or (3), as applicable. Any deduction attributable to more than one unrelated trade or business must be allocated in accordance with §1.512(a)-1(c) of the current regulations.

6. *NOLs and UBTI*

a. *NOL Deduction Calculated Separately with Respect to Each Trade or Business*

Consistent with the statute and the proposed regulations, the final regulations provide that, for taxable years beginning after December 31, 2017, an exempt organization with more than one unrelated trade or business determines the NOL deduction allowed by sections 172(a) and 512(b)(6) separately with respect to each of its unrelated trades or businesses. Also consistent with the proposed regulations, the final regulations provide that §1.512(b)-1(e), which addresses the application of section 172 in the context of UBIT, applies separately with respect to each such unrelated trade or business.

b. *Coordination of NOLs*

The proposed regulations provided that an exempt organization with losses arising in a taxable year beginning before January 1, 2018 (pre-2018 NOLs), and losses arising in a taxable year beginning after December 31, 2017 (post-2017 NOLs), deducts its pre-2018 NOLs from total UBTI before deducting any post-2017 NOLs with regard to a separate unrelated trade or business against the UBTI from such trade or business. One commenter recommended that an exempt organization be permitted to choose the order in which it uses pre-2018 and post-2017 NOLs based on its own facts and circumstances.

The Treasury Department and the IRS do not accept this recommendation. Section 1.172-4(a)(3) of the current regulations provides that the amount which is carried back or carried over to any taxable year is an NOL "to the extent it was not absorbed in the computation of the taxable (or net) income for other taxable years, preceding such taxable year, to which it may be carried back or carried over." This section further provides that, for the purpose of determining the taxable (or net) income for any such preceding taxable year, the various NOL carryovers and carrybacks to such taxable year are considered to be applied in reduction of the taxable (or net) income in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for

the earliest taxable year. Furthermore, in Notice 2018-67, the Treasury Department and the IRS noted that section 512(a)(6) may have changed the order in which NOLs are taken and requested comments regarding how the NOL deduction should be taken under section 512(a)(6) by exempt organizations with more than one unrelated trade or business and, in particular, by such organizations with both pre-2018 and post-2017 NOLs. Comments received in response to Notice 2018-67 noted that section 512(a)(6) does not alter the ordering rules under section 172 and that pre-2018 NOLs should be allowed prior to post-2017 NOLs, especially because pre-2018 NOLs remain subject to a carry-forward limitation. The commenter on the proposed regulations provided no new information that would support changing the NOL ordering rule for purposes of section 512(a)(6). Accordingly, the final regulations adopt the proposed regulations without change.

The proposed regulations further provided that pre-2018 NOLs are taken against total UBTI in the manner that results in maximum utilization of the pre-2018 NOLs in a taxable year. One commenter requested that the final regulations clarify the methodology or principle that should be used to allocate pre-2018 NOLs among separate unrelated trades or businesses. The methods suggested by this commenter would result in the pro-rata distribution of pre-2018 NOLs based on various factors, such as the ratio of UBTI of a separate unrelated trade or business to total UBTI. In the alternative, two commenters proposed that an exempt organization be permitted to use any reasonable method to allocate its pre-2018 NOLs.

Although pre-2018 NOLs are taken against total UBTI, pre-2018 NOLs must be allocated in some manner between separate unrelated trades or businesses to determine the amount of pre-2018 NOLs actually taken in a taxable year because the UBTI with respect to each separate unrelated trade or business is calculated before total UBTI and post-2017 NOLs are taken against the UBTI of the separate unrelated trade or business in which they arose. Pre-2018 NOLs could be allocated any number of ways, including ratably between separate unrelated trades or businesses

or only to those separate unrelated trades or businesses with no post-2017 NOLs. In permitting the “maximum utilization of the pre-2018 NOLs in a taxable year” in the proposed regulations, the Treasury Department and the IRS intended to provide exempt organizations with the flexibility to choose how to allocate pre-2018 NOLs among separate unrelated trades or businesses. However, the actual effect of this rule is to permit an exempt organization to maximize post-2017 NOLs taken against the UBTI from the separate unrelated trades or businesses after taking the pre-2018 NOLs. Accordingly, the final regulations clarify that pre-2018 NOLs are taken against the total UBTI in a manner that allows for maximum utilization of post-2017 NOLs, rather than pre-2018 NOLs, in a taxable year. For example, the final regulations further clarify that an exempt organization may allocate all of its pre-2018 NOLs to one of its separate unrelated trades or businesses or it may allocate its pre-2018 NOLs ratably among its separate unrelated trades or businesses, whichever results in the greater utilization of the post-2017 NOLs in that taxable year.

Additionally, several commenters requested guidance regarding how changes made to section 172 by the Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136, 134 Stat. 281 (2020) (CARES Act) would affect section 512(a)(6). The Treasury Department and the IRS are considering how these changes affect the calculation of UBTI under section 512(a)(6) and expect to publish additional guidance on the issue. It is anticipated that this additional guidance will include examples that illustrate both how the changes to the CARES Act affect the calculation of UBTI as well as how an exempt organization calculates UBTI when it has pre-2018 NOLs, either with or without post-2017 NOLs.

c. Treatment of NOLs upon Sale, Transfer, Termination, or Other Disposition of a Separate Unrelated Trade or Business

Several commenters requested guidance on the treatment of accumulated NOLs upon the sale, transfer, termination, or other disposition of a separate unrelated trade or business. At least one commenter

recommended that, in such an event, the use of all such prior losses be applied first to any gain realized on the disposition of the trade or business and that any remaining losses be permitted to offset UBTI from other, separate unrelated trades or businesses. Another commenter recommended that any accumulated NOLs be suspended and taken if the exempt organization later resumes the separate unrelated trade or business.

Section 512(a)(6) permits only pre-2018 NOLs to be taken against total UBTI. Consistent with the legislative intent of section 512(a)(6), losses attributable to a separate unrelated trade or business may be taken only against income from that separate unrelated trade or business. However, the Treasury Department and the IRS recognize that an exempt organization later may recommence that separate unrelated trade or business or acquire a separate unrelated trade or business identified in the same manner. Accordingly, the final regulations provide that, after offsetting any gain from the termination, sale, exchange, or other disposition of a separate unrelated trade or business, any NOL remaining is suspended. However, the suspended NOLs may be used if that previous separate unrelated trade or business is later resumed or if a new unrelated trade or business that is accurately identified using the same NAICS 2-digit code as the previous separate unrelated trade or business is commenced or acquired in a future taxable year.

d. Treatment of NOLs Upon Changing Identification of a Separate Unrelated Trade or Business

Six commenters requested that the final regulations clarify what happens to NOLs when a partnership interest moves in and out of QPI status. The Treasury Department and the IRS expect that the grace period described in part 2.b.vi of this Summary of Comments and Explanation of Revisions will reduce the incidence of partnership interests moving in and out of QPI status. Nonetheless, instances will exist where a partnership interest that was a QPI becomes a non-QPI. Additionally, as discussed in part 1.d of this Summary of Comments and Explanation of Revisions, an exempt organization may change the

NAICS 2-digit code identifying a separate unrelated trade or business. Thus, the same question exists regarding what happens to NOLs when the NAICS 2-digit code identifying a separate unrelated trade or business changes.

In response to the commenters, the final regulations generally provide that, for purposes of section 512(a)(6), a separate unrelated trade or business that changes identification is treated as if the originally identified separate unrelated trade or business is terminated and a new separate unrelated trade or business is commenced. As a result, none of the NOLs from the previously identified separate unrelated trade or business will be carried over to the newly identified separate unrelated trade or business. For example, if the nature of a separate unrelated trade or business changes such that it is more accurately described by another NAICS 2-digit code, the separate unrelated trade or business is treated as a new separate unrelated trade or business with no NOLs.

The final regulations further clarify that the change in identification may apply to all or a part of the originally identified separate unrelated trade or business. If the change in identification applies to the originally identified separate trade or business in its entirety, any NOLs attributable to that separate unrelated trade or business are suspended. If the change in identification applies to the originally identified separate unrelated trade or business in part, to aid in tax administration and to avoid a need for allocation of NOLs within an originally identified separate trade or business, the originally identified separate unrelated trade or business that is not changing retains the full NOLs attributable to it, including the portion for which the identification is changing. Additionally, the final regulations provide that this general rule also applies to the separate unrelated trades or businesses that are identified when a QPI becomes a non-QPI. In this case, any NOLs attributable to the QPI that became a non-QPI are retained with the organization’s investment activities.

Under the final regulations, a change in identification is effective as of the first day of the taxable year in which the change is made. Accordingly, the final regulations treat the newly identified separate unre-

lated trade or business as commencing on this date.

Nonetheless, the final regulations provide an exception for when an organization has determined that an unrelated trade or business is more accurately identified by another NAICS 2-digit code, provided that there has been no material change in the unrelated trade or business. In these cases, the final regulations provide that the NOLs attributable to the previously identified separate unrelated trade or business are NOLs of the newly identified separate unrelated trade or business. This approach is consistent with the legislative intent that losses from one unrelated trade or business not be used to offset the gains from another unrelated trade or business but recognizes that mistakes may be made and that NOLs should not be suspended (as discussed in part 6.c of this Summary of Comments and Explanation of Revisions) in such a case. The final regulations provide examples illustrating the application of these rules regarding NOLs.

e. Coordination of NOL and Excess Charitable Contribution Carryovers

The proposed regulations requested comments on the coordination of NOL and excess contribution carryovers. The proposed regulations noted that an ordering rule may be necessary. Although a few comments were received, these final regulations do not address this issue. The Treasury Department and the IRS continue to consider this issue and will issue additional guidance, if needed.

7. Form 990-T

At least one commenter requested clarification regarding the reporting of separate unrelated trades or businesses that do not have corresponding NAICS codes, such as investment activities, income from certain controlled entities, and non-qualifying S corporation interests. The IRS is in the process of revising the 2020 Form 990-T and related instructions. It is anticipated that separate unrelated trades or businesses that are not identified using NAICS 2-digit codes – that is, separate unrelated trades or businesses identified under §1.512(a)-6(c) (investment activities), (d)(1) (specified payments

from controlled entities), (d)(2) (certain amounts derived from controlled foreign corporations), and (e) (non-qualifying S corporation interests) – will be identified using numeric codes distinguishable from NAICS codes. The instructions to the Form 990-T will explain how an exempt organization determines the appropriate code to use, as well as how to report code changes.

8. Waiver of Penalties Not Provided

One commenter requested that the Treasury Department and the IRS waive any penalties arising from the underpayment of tax for tax years prior to the applicability date of the final regulations. As discussed in the Applicability Dates section of this preamble, an exempt organization may rely on a reasonable, good-faith interpretation of section 512(a)(6) prior to the applicability date of the final regulations. Accordingly, the Treasury Department and the IRS decline to waive any underpayment penalties with respect to the calculation of UBTI under section 512(a)(6).

9. Individual Retirement Accounts

The proposed regulations added a new paragraph to §1.513-1 clarifying that the section 513(b) definition of “unrelated trade or business” applies to individual retirement accounts (IRAs) described in section 408. No comments were received with respect to this provision. Accordingly, the final regulations adopt these proposed regulations without change.

10. Inclusions of Subpart F Income and Global Intangible Low-Taxed Income

The proposed regulations revised §1.512(b)-1(a) to clarify that an inclusion of subpart F income under section 951(a)(1)(A) is treated in the same manner as a dividend for purposes of section 512(b)(1) and that an inclusion of global intangible low-taxed income (GILTI) under section 951A(a) is treated in the same manner as an inclusion of subpart F income under section 951(a)(1)(A) for purposes of section 512(b)(1). At least one commenter explicitly supported this treatment of an inclusion of subpart F income or GILTI and

no other comments were received. Therefore, the final regulations adopt these proposed regulations without change.

11. Public Support

The preamble to the proposed regulations confirmed that section 512(a)(6) potentially impacted the calculation of public support under sections 509(a)(1) and 170(b)(1)(A)(vi) and under section 509(a)(2) (the public support tests) because of the inability of an exempt organization with more than one unrelated trade or business to use losses from one unrelated trade or business to offset gains from another unrelated trade or business. Furthermore, the preamble to the proposed regulations noted that the Treasury Department and the IRS were not aware of any congressional intent to change the public support tests in enacting section 512(a)(6). Accordingly, the proposed regulations revised §§1.170A-9(f) and 1.509(a)-3 to permit an organization with more than one unrelated trade or business to aggregate its net income and net losses from all of its unrelated business activities, including unrelated trades or businesses within the meaning of section 512, for purposes of determining whether an organization is publicly supported.

Commenters agreed that Congress likely did not intend to change the public support tests when enacting section 512(a)(6) and generally supported the proposed clarifications to the public support test. However, two commenters noted that an exempt organization that satisfies the public support tests using its UBTI calculated for purposes of section 512(a)(6) also will satisfy the public support tests if it calculates its UBTI in the aggregate. These commenters therefore recommended that an exempt organization be permitted to use either its UBTI calculated under section 512(a)(6) or its UBTI calculated in the aggregate to determine public support. These commenters noted that this approach would reduce the administrative burden on exempt organizations because organizations that satisfy the requirements of the public support test using their UBTI calculated under section 512(a)(6) would not be required to recalculate UBTI in the aggregate. At the same time, this approach would also address any unintended

consequence of the enactment of section 512(a)(6) for exempt organizations that have historically satisfied the requirements of the public support test but would no longer because of the effect of section 512(a)(6). The final regulations adopt these commenters' suggestions and permit an exempt organization with more than one unrelated trade or business to determine public support using either its UBTI calculated under section 512(a)(6) or its UBTI calculated in the aggregate.

12. *Technical Correction of Inadvertently Omitted Regulatory Language*

The proposed regulations made a technical correction to §1.512(a)-1(b) by including language that was omitted from the **Federal Register** when the final regulation was published in 1975. No comments were received with respect to this technical correction. Accordingly, the final regulations adopt the technical correction in the proposed regulations without change.

Applicability Dates

The proposed regulations were proposed to apply to taxable years beginning on or after the date the regulations were published in the **Federal Register** as final regulations. Two commenters recommended that the applicability date of the final regulations be delayed. Another commenter suggested that the applicability date be extended such that all exempt organizations be provided with at least one year before the final regulations are applicable. This commenter explained that time will be required to implement the final regulations, including making changes to accounting systems. Accordingly, this commenter proposed that the applicability date of the final regulations be extended to the first day of the second taxable year beginning after the date the final regulations are published in the **Federal Register**.

The Treasury Department and the IRS recognize that implementation of the requirements of section 512(a)(6) by some exempt organizations requires changes to the way these organizations track income and expenses. However, the Treasury Department and the IRS have provided guidance regarding how exempt organizations

would be expected to comply with section 512(a)(6) starting with Notice 2018-67 in September of 2018 and continuing with the proposed regulations in April of 2020. The final regulations adopt the proposed regulations with minor changes requested by commenters. Accordingly, consistent with the proposed regulations, the final regulations are applicable to taxable years beginning on or after December 2, 2020. In addition, an exempt organization may choose to apply the final regulations under section 512(a)(6), as well as the final regulations relating to the calculation of public support, to taxable years beginning on or after January 1, 2018, and before December 2, 2020. Alternatively, an exempt organization may rely on a reasonable, good-faith interpretation of section 512(a)(6) for such taxable years. For this purpose, a reasonable good faith interpretation includes the methods of aggregating or identifying separate trades or businesses provided in Notice 2018-67 or the proposed regulation.

With respect to the inclusions of subpart F income or GILTI discussed in part 10 of the Summary of Comments and Explanation of Revisions, a taxpayer may choose to apply the final regulations under §1.512(b)-1(a) to taxable years beginning before December 2, 2020 consistent with the longstanding position of the Treasury Department and the IRS on the inclusion of subpart F income under section 951(a)(1)(A).

Statement of Availability of IRS Documents

For copies of recently issued Revenue Procedures, Revenue Rulings, Notices, and other guidance published in the Internal Revenue Bulletin, please visit the IRS Web site at <http://www.irs.gov> or the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866, 13563, and 13771 direct agencies to assess costs and benefits of available regulatory alterna-

tives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health, and safety effects; distributive impacts; and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

These final regulations have been designated as significant and subject to review under Executive Order 12866 and section 1(b) of the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. For purposes of Executive Order 13771, the final regulations are regulatory. The Administrator of the Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget, has waived review of this rule in accordance with section 6(a)(3)(A) of Executive Order 12866.

1. Background

Certain corporations, trusts, and other entities are exempt from Federal income taxation because of the specific functions they perform (exempt organizations). Examples include religious and charitable organizations. However, exempt organizations that engage in business activities that are not substantially related to their exempt purposes may have taxable income under section 511(a)(1) of the Internal Revenue Code (Code). For example, the income that a tax-exempt organization generates from the sale of advertising in its quarterly magazine is unrelated business taxable income (UBTI).

Prior to the Tax Cuts and Jobs Act (TCJA), UBTI was calculated by aggregating the net incomes from all the unrelated business activities conducted by an exempt organization. As a result, losses from one unrelated trade or business activity could be used to offset profits from another unrelated trade or business activity. New section 512(a)(6), enacted in the TCJA, provides that organizations with more than one unrelated trade or business calculate the taxable amounts separately for each trade or business so that losses only offset income from the same unrelated trade or business. The statuto-

ry language, however, does not specify standards for determining what activities would be considered the same or a different trade or business.

On April 21, 2020, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-106864-18) in the **Federal Register** (85 FR 23172) containing proposed regulations under section 512 (proposed regulations). The final regulations retain the basic approach and structure of the proposed regulations with certain minor modifications. As part of these modifications, the final regulations modify the participation test (called the “control test” in the proposed regulations) to permit indirectly held partnerships interests to be eligible for inclusion in an exempt organization’s single “investment activities” trade or business. The final regulations address the need for guidance by providing rules for determining when an exempt organization has more than one unrelated trade or business and how such an exempt organization computes UBTI under new section 512(a)(6). Specifically discussed below, the final regulations establish guidelines for (1) identifying separate unrelated trades or businesses; and (2) in certain cases, permitting an exempt organization to treat investment activities as one unrelated trade or business for purposes of computing UBTI.

2. Baseline

In this analysis, the Treasury Department and the IRS assess the benefits and costs of these proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

3. Affected Entities

Prior tax law did not require tax-exempt organizations to report unrelated business income by separate activity, so it is not possible to obtain accurate counts of the number of exempt organizations po-

tentially affected by the final regulations. However, the IRS estimates that less than 2 percent of exempt organizations would be affected, as calculated below.

Approximately 1.4 million exempt organizations filed some type of information or tax return with the IRS for fiscal year 2018.⁷ Only 188,000 exempt organizations filed Form 990-T, which is used to report UBTI. While not all Form 990-T filers also file an information return with the IRS, as an upper bound estimate, 14 percent of exempt organizations could be affected by the regulations. Within Form 990-T filers, only a smaller subset, primarily the largest organizations in certain categories, are expected to have more than one unrelated trade or business. Among the types of organizations expected to have more than one unrelated trade or business are colleges and universities, certain cultural organizations such as museums, and some tax-exempt hospitals.

Additional information on organizations that may be affected is provided by a 2018 Center on Nonprofits and Philanthropy (CNP) survey of 723 primarily large exempt organizations.⁸ Three-hundred and thirty of these organizations reported that they had filed a Form 990-T. Of these, 70 percent had revenues over \$10 million and most were educational or arts and cultural organizations. Only 46 organizations (14 percent of the surveyed organizations filing Form 990-T) reported having more than one source of UBTI and almost half of these had only two sources. Thus, the Treasury Department and the IRS project that if the CNP survey results applied to the population of Form 990-T filers, then less than 2 percent of exempt organizations or approximately 4,000 filers would be affected by the final regulations and that these would tend to be large educational or arts and cultural organizations.

4. Economic Analysis of Final Regulations

The final regulations provide greater certainty to exempt organizations re-

garding how to compute UBTI and tax in response to the changes made by TCJA. They also improve economic efficiency by helping to ensure that similar exempt organizations are taxed similarly. In the absence of this guidance taxpayers might make different assumptions regarding how to calculate UBTI and tax.

This section describes the two major provisions of the final rule and provides a qualitative economic analysis of each one.

a. Identifying Separate Trades or Businesses

Section 512(a)(6) requires exempt organizations with more than one unrelated trade or business to calculate UBTI separately for each trade or business so that losses are used to offset only income from the same unrelated trade or business. The final regulations generally require the use of NAICS codes to identify separate unrelated trades or businesses. NAICS is an industry classification system for purposes of collecting, analyzing, and publishing statistical data related to the United States business economy. Each digit of the NAICS 6-digit codes describes an industry with increasing specificity. The final regulations allow the use of NAICS 2-digit codes, which encompass broader categories of trades or businesses than NAICS 6-digit codes, to reduce the compliance burdens for exempt organizations with multiple similar types of business activity. For example, different types of food services would be included in the same NAICS 2-digit code as opposed to separate NAICS 6-digit codes. Similarly, different types of recreational activities, such as fitness centers and golf courses, would be in the same NAICS 2-digit code as opposed to separate NAICS 6-digit codes. A single facility might have elements fitting several of these categories, which could change over time when NAICS codes are revised. The use of NAICS 6-digit codes could potentially require an exempt organization to split what has traditionally been considered one unrelated trade or business into multiple unrelated trades or businesses.

⁷See Internal Revenue Service Research, Applied Analytics, and Statistics, Statistics of Income Division Fiscal Year Return Projections for the United States Publication 6292 (Rev. 9-2019), Projected Returns 2019-2026. Exempt organizations generally must file an annual information return with IRS. See generally section 6033. However, churches and small organizations are exempt from this filing requirement. See section 6033(a)(3). Organizations that have more than \$1,000 in gross UBTI must also file Form 990-T to calculate their UBTI and tax. See section 512(b)(12) (providing a \$1,000 specific deduction).

⁸See Elizabeth Boris and Joseph Cordes, “How the TCJA’s New UBIT Provisions Will Affect Nonprofits,” Urban Institute Research Report, January 2019.

In addition, exempt organizations may need to incur the costs of changing their accounting systems so as to collect the information needed for separate NAICS 6-digit codes.

Some commenters to the proposed regulations advocated using the NAICS 2-digit codes as a safe-harbor when identifying separate unrelated trades or businesses and that a facts and circumstances test be applied as the primary method of identifying separate unrelated businesses. Adoption of a facts and circumstances test would increase the administrative burden of tax-exempt organizations in complying with section 512(a)(6) because fact-intensive analysis would be required to determine each unrelated trade or business. Additionally, adoption of a facts and circumstances test would offer exempt organizations less certainty and increase the IRS administrative burden.

The guidance provided in the final regulations ensures that the tax liability is calculated similarly across taxpayers, avoiding situations where one taxpayer receives differential treatment compared to another taxpayer for fundamentally similar economic activity based on their differing reasonable, good-faith interpretations of the statute. In the absence of these final regulations, an exempt organization might be uncertain about whether an activity is one or more than one trade or business. As a result, in the absence of the final regulations, similar institutions might take different positions and pay different amounts of tax, introducing economic inefficiency and inequity. These regulations provide greater certainty and flexibility such that compliance costs may be slightly lower for affected organizations relative to a no-action baseline.

b. Aggregation of Investment Activities

The final regulation's treatment of investment activities will also provide clarity and reduce burdens for exempt organizations. By providing explicit rules for the treatment of investment activities, the final regulations reduce the uncertainty about what would be acceptable under a reasonable, good-faith interpretation. Although investment income, such as interest and dividend in-

come, is not generally statutorily taxed as UBTI, exempt organizations may engage in certain activities that the organization considers "investments" but that generate UBTI, such as debt-financed investments or investments through partnerships. The final regulations allow certain of this investment income to be aggregated and treated as a single trade or business. The final regulations provide rules for the treatment of partnership income and explicitly list the other types of UBTI that can be aggregated as "investment" income in response to comments requesting additional clarification. The allowance of this type of aggregation is responsive to situations where exempt organizations are invested in partnerships in which they do not significantly participate. The allowance of aggregation in the final regulations recognizes that in these situations the exempt organizations are unlikely to be able to access information from such partnerships for purposes of separating the partnerships' investments according to NAICS codes. As a result, the final regulations reduce the compliance burdens of exempt organizations of obtaining information from partnerships and simplify the calculation of UBTI when the income is generated from "investment" activities relative to the no-action baseline.

c. Summary

The final regulations provide rules for determining when an exempt organization has more than one unrelated trade or business and how such an exempt organization computes UBTI. In addition, the final regulations provide guidelines for when an exempt organization treats its investment activities as one unrelated trade or business for purposes of computing UBTI. In the absence of guidance, affected taxpayers may face more uncertainty when calculating their tax liability, a situation generally that could lead to greater conflicts with tax administrators. The Treasury Department and the IRS project that the final regulations will reduce taxpayer compliance burden relative to the no-action baseline. In addition, the Treasury Department and the IRS project that these regulations will affect a small number of exempt organizations. Based on this anal-

ysis, the Treasury Department and the IRS anticipate any economic effects of the final regulations will be modest relative to the no-action baseline.

II. Paperwork Reduction Act

The collections of information contained in the final regulations will be submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of (1995) (44 U.S.C. 3507(d)). 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.

1. Collections of Information Imposed by the Regulations

The collection of information in these final regulations is in §1.512(b)-6(a). This information is required to determine whether an exempt organization has more than one unrelated trade or business and therefore must report those unrelated trades or businesses on Form 990-T and related schedules. In 2018, the IRS released and invited comments on drafts of an earlier version of the Form 990-T and related schedules to give members of the public opportunity to comment on changes made to the Form 990-T, and the addition of a new schedule to report additional unrelated trades or businesses, as required by the enactment of section 512(a)(6). The IRS received no comments on the Form 990-T and related schedules during that comment period. Consequently, the IRS made Form 990-T available on January 8, 2019, and the new schedule for reporting additional unrelated trades or businesses available on January 25, 2019, for use by the public. The IRS intends that the burden of collections of information will be reflected in the burden associated with the Form 990 series under OMB approval number 1545-0047.

2. Burden Estimates

The burden associated with Form 990-T is included in the aggregated burden estimates for OMB control number 1545-0047. The burden estimates in 1545-0047 relate to all filers associated with the Forms 990, and will in the future include,

but not isolate, the estimated burden of the information collections associated with these final regulations.

No burden estimates specific to the final regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information collections, related to

the requirements under the final regulations. Those estimates would capture both changes made by the Act and those that arise out of discretionary authority exercised in the final regulations. The current status of the Paperwork Reduction Act submissions related to these final regulations is provided in the following table.

Form	OMB Control Number	Status
990 and related forms	1545-0047	Sixty-day notice published on 9/24/2019. Thirty-day notice published on 12/31/2019. Approved by OIRA on 2/12/2020.
		Link: https://www.irs.gov/forms-pubs/about-form-990

In the proposed regulations, the Treasury Department and the IRS requested comments on all aspects of information collection burdens related to the regulations, including estimates for how much time it would take to comply with the paperwork burdens described above for each relevant form and ways for the IRS to minimize the paperwork burden. The Treasury Department and the IRS did not receive any comments on these issues. Proposed revisions (if any) to the forms that reflect the information collections contained in these final regulations will be made available for public comment at <https://apps.irs.gov/app/picklist/list/draftTaxForms.html> and will not be finalized until after these forms have been approved by OMB under the PRA. Comments on these forms can be submitted at <https://www.irs.gov/forms-pubs/comment-on-tax-forms-and-publications>.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. In the proposed regulations, the Treasury Department and the IRS invited comments on the impact this rule may have on small entities. The Treasury Department and the IRS did not receive any comments on this issue. As discussed elsewhere in this section, these final regulations apply to all exempt organizations with UBTI, but only to the extent required to determine if an exempt organization has more than

one unrelated trade or business. If an exempt organization only has one unrelated trade or business, these regulations do not apply and the exempt organization determines UBTI under section 512(a)(1) or section 512(a)(3), as appropriate. If an exempt organization has more than one unrelated trade or business, these proposed regulations provide instructions for computing UBTI separately with respect to each such unrelated trade or business.

These final regulations are not likely to affect a substantial number of small entities. According to the IRS Data Book, 1,835,534 exempt organizations existed in 2018. INTERNAL REVENUE SERVICE, PUBLICATION 55B, INTERNAL REVENUE SERVICE DATA BOOK 2018, 57 (May 2019). However, only 188,334 Form 990-Ts were filed in 2018. INTERNAL REVENUE SERVICE, PUBLICATION 6292, FISCAL YEAR RETURN PROJECTS FOR THE UNITED STATES: 2019-2026, FALL 2019 4 (September 2019). Accordingly, approximately 10 percent of the exempt organization population file Form 990-T. This population includes large hospital systems and universities not included in the SBA definition of “small entities.” Therefore, these final regulations are not likely to affect a substantial number of small entities.

Even if the regulations affected a substantial number of small entities, the economic impact of these final rules is not likely to be significant. An organization affected by this rule, with more than one unrelated trade or business, completes Part I and Part II on page 1 of Form 990-T and completes and attaches a separate schedule for each additional unrelated

trade or business. Affected taxpayers have been reporting UBTI on form 990-T for separate unrelated trades or businesses for the previous two tax years. As discussed elsewhere in this section, these regulations provide certainty and guidance for these organizations. In the absence of this guidance, affected taxpayers may face more uncertainty when calculating their tax liability, a situation generally that could lead to greater conflicts with tax administrators. Although affected taxpayers will have to spend time reading these final regulations, the Treasury Department and the IRS project that the final regulations provide certainty and guidance that will reduce taxpayer compliance burden for large and small entity taxpayers. Accordingly, the Secretary of the Treasury’s delegate certifies that these regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f), the notice of proposed rulemaking was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business (84 FR 31795). No comments on the notice were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

IV. Congressional Review Act

The Office of Management and Budget has determined that the final rule is not a “major rule” within the meaning of the Congressional Review Act (5 U.S.C. 801, et seq.).

V. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. The final regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

VII. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The final regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive order.

Drafting Information

The principal authors of these regulations are Stephanie N. Robbins and Jonathan A. Carter, Office of the Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 are amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.170A-9 is amended by:

1. Adding paragraph (f)(7)(v).
2. Adding paragraph (k)(3).

The additions read as follows:

§1.170A-9 Definition of section 170(b)(1)(A) organization.

* * * * *

(f) * * *

(7) * * *

(v) *Unrelated business activities.* The term *net income from unrelated business activities* in section 509(d)(3) includes (but is not limited to) an organization’s unrelated business taxable income (UBTI) within the meaning of section 512. However, when calculating UBTI for purposes of determining support (within the meaning of this paragraph (f)(7)), section 512(a)(6) does not apply. Accordingly, in the case of an organization that derives gross income from the regular conduct of two or more unrelated business activities, support includes the aggregate of gross income from all such unrelated business activities less the aggregate of the deductions allowed with respect to all such unrelated business activities. Nonetheless, when determining support, such organization can use either its UBTI calculated under section 512(a)(6) or its UBTI calculated in the aggregate.

* * * * *

(k) * * *

(3) *Applicability date.* Paragraph (f)(7)(v) of this section applies to taxable years beginning on or after December 2, 2020. Taxpayers may choose to apply this section to taxable years beginning on or after January 1, 2018, and before December 2, 2020.

Par. 3. Section 1.509(a)-3 is amended by:

1. Revising the first sentence of paragraph (a)(3)(i).
2. Redesignating paragraph (a)(4) as paragraph (a)(5).
3. Adding new paragraph (a)(4).
4. Revising paragraph (o).

The revisions and additions read as follows:

§1.509(a)-3 Broadly, publicly supported organizations.

(a) * * *

(3) * * *

(i) * * * An organization will meet the not-more-than-one-third support test under section 509(a)(2)(B) if it normally (within the meaning of paragraph (c) or (d) of this section) receives not more than one-third of its support in each taxable year from the sum of its gross investment income (as defined in section 509(e)) and the excess (if any) of the amount of its unrelated business taxable income (as defined in section 512, without regard to section 512(a)(6), or with regard to section 512(a)(6), if the organization so chooses) derived from trades or businesses that were acquired by the organization after June 30, 1975, over the amount of tax imposed on such income by section 511.

* * * * *

(4) *Unrelated business activities.* The denominator of the one-third support fraction and the denominator of the not-more-than-one-third support fraction both include net income from unrelated business activities, whether or not such activities are carried on regularly as a trade or business. The term *net income from unrelated business activities* includes (but is not limited to) an organization’s unrelated business taxable income (UBTI) within the meaning of section 512. However, when calculating UBTI for purposes of determining the denominator of both support fractions, section 512(a)(6) does not apply. Accordingly, in the case of an organization that derives gross income from the regular conduct of two or more unrelated business activities, support includes the aggregate of gross income from all such unrelated business activities less the aggregate of the deductions allowed with respect to all such unrelated business activities. Nonetheless, when determining support, such organization can use either its UBTI calculated under section 512(a)(6) or its UBTI calculated in the aggregate.

* * * * *

(o) *Applicability date.* This section generally applies to taxable years beginning after December 31, 1969, except paragraphs (a)(3)(i) and (a)(4) of this section apply to taxable years beginning on or after December 2, 2020. Taxpayers

may choose to apply this section to taxable years beginning on or after January 1, 2018, and before December 2, 2020. Otherwise, for taxable years beginning before December 2, 2020, see these paragraphs as in effect and contained in 26 CFR part 1 revised as of April 1, 2020.

Par. 4. Section 1.512(a)-1 is amended by:

1. Revising the first and fourth sentence of paragraph (a).
2. Revising the first and second sentence of paragraph (b).
3. Adding two sentences to the end of paragraph (c).
4. Revising paragraph (h).

The revisions and additions read as follows:

§1.512(a)-1 Definition.

(a) * * * Except as otherwise provided in §1.512(a)-3, §1.512(a)-4, or paragraph (f) of this section, section 512(a)(1) defines *unrelated business taxable income* as the gross income derived from any unrelated trade or business regularly carried on, less those deductions allowed by chapter 1 of the Internal Revenue Code (Code) which are directly connected with the carrying on of such trade or business, subject to certain modifications referred to in §1.512(b)-1. * * * In the case of an organization with more than one unrelated trade or business, unrelated business taxable income is calculated separately with respect to each such trade or business. See §1.512(a)-6. * * *

(b) * * * Expenses, depreciation, and similar items attributable solely to the conduct of unrelated business activities are proximately and primarily related to that business activity, and therefore qualify for deduction to the extent that they meet the requirements of section 162, section 167, or other relevant provisions of the Code. Thus, for example, salaries of personnel employed full-time in carrying on unrelated business activities are directly connected with the conduct of that activity and are deductible in computing unrelated business taxable income if they otherwise qualify for deduction under the requirements of section 162. * * *

(c) * * * However, allocation of expenses, depreciation, and similar items is not reasonable if the cost of providing a

good or service in a related and an unrelated activity is substantially the same, but the price charged for that good or service in the unrelated activity is greater than the price charged in the related activity and no adjustment is made to equalize the price difference for purposes of allocating expenses, depreciation, and similar items based on revenue between related and unrelated activities. For example, if a social club described in section 501(c)(7) charges nonmembers a higher price than it charges members for the same good or service but does not adjust the price of the good or service provided to members for purposes of allocating expenses, depreciation, and similar items attributable to the provision of that good or service, the allocation method is not reasonable.

* * * * *

(h) *Applicability date.* This section generally applies to taxable years beginning after December 12, 1967, except as provided in paragraph (g)(2) of this section, and except that paragraphs (a) through (c) of this section apply to taxable years beginning on or after December 2, 2020. For taxable years beginning before December 2, 2020, see these paragraphs as in effect and contained in 26 CFR part 1 revised as of April 1, 2020.

Par. 5. Section 1.512(a)-6 is added to read as follows:

§1.512(a)-6 Special rule for organizations with more than one unrelated trade or business.

(a) *More than one unrelated trade or business*—(1) *In general.* An organization with more than one unrelated trade or business must compute unrelated business taxable income (UBTI) separately with respect to each such trade or business, without regard to the specific deduction in section 512(b)(12), including for purposes of determining any net operating loss (NOL) deduction. An organization with more than one unrelated trade or business computes its total UBTI under paragraph (g) of this section.

(2) *Separate trades or businesses.* An organization determines whether it regularly carries on unrelated trades or businesses by applying sections 511 through 514. For purposes of section 512(a)(6)(A) and paragraph (a)(1) of this section, an or-

ganization identifies its separate unrelated trades or businesses using the methods described in paragraphs (b) through (e) of this section.

(3) *Reporting changes in identification.* An organization that changes the identification of a separate unrelated trade or business under paragraph (a)(2) of this section must report the change in the taxable year of that change in accordance with forms and instructions. For this purpose, a change in identification of a separate unrelated trade or business includes the changed identification of the separate unrelated trade or business with respect to a partnership interest that was incorrectly designated as a qualifying partnership interest (QPI). In the case of an incorrect designation of a QPI, paragraph (c)(2)(iii) of this section (regarding designation of qualifying partnership interests) does not apply. In all cases, to report the change in identification, an organization must provide the following information with respect to each separate change in identification—

(i) The identification of the separate unrelated trade or business in the previous taxable year;

(ii) The identification of the separate unrelated trade or business in the current taxable year; and

(iii) The reason for the change.

(b) *North American Industry Classification System*—(1) *In general.* Except as provided in paragraphs (c) through (e) of this section, an organization identifies each of its separate unrelated trades or businesses using the first two digits of the North American Industry Classification System code (NAICS 2-digit code) that most accurately describes the unrelated trade or business based on the more specific NAICS code, such as at the 6-digit level, that describes the activity it conducts and subject to the requirements of paragraph (b)(2) and (3) of this section. The descriptions in the current NAICS manual (available at www.census.gov) of trades or businesses using more than two digits of the NAICS codes are relevant in this determination. In the case of the sale of goods, both online and in stores, the separate unrelated trade or business is identified by the goods sold in stores if the same goods generally are sold both online and in stores.

(2) *Codes must identify the unrelated trade or business.* The NAICS 2-digit code must identify the unrelated trade or business in which the organization engages (directly or indirectly) and not activities the conduct of which are substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 (or, in the case of an organization described in section 511(a) (2)(B), to the exercise or performance of any purpose or function described in section 501(c)(3)). For example, a college or university described in section 501(c)(3) cannot use the NAICS 2-digit code for educational services to identify all its separate unrelated trades or businesses, and a qualified retirement plan described in section 401(a) cannot use the NAICS 2-digit code for finance and insurance to identify all of its unrelated trades or businesses.

(3) *Codes only reported once.* An organization will report each NAICS 2-digit code only once. For example, a hospital organization that operates several hospital facilities in a geographic area (or multiple geographic areas), all of which include pharmacies that sell goods to the general public, would include all the pharmacies under the NAICS 2-digit code for retail trade, regardless of whether the hospital organization keeps separate books and records for each pharmacy.

(c) *Activities in the nature of investments*—(1) *In general.* An organization's activities in the nature of investments (investment activities) are treated collectively as a separate unrelated trade or business for purposes of section 512(a)(6) and paragraph (a) of this section. Except as provided in paragraphs (c)(7) and (c)(8) of this section, an organization's investment activities are limited to its—

- (i) Qualifying partnership interests (described in paragraph (c)(2) of this section);
- (ii) Qualifying S corporation interests (described in paragraph (e)(2)(i) of this section); and
- (iii) Debt-financed property or properties (within the meaning of section 514).

(2) *Qualifying partnership interests*—(i) *Directly-held partnership interests.* An interest in a partnership is a qualifying partnership interest (QPI) if the exempt organization holds a direct interest in

the partnership (directly-held partnership interest) that meets the requirements of either the de minimis test (described in paragraph (c)(3) of this section) or the participation test (described in paragraph (c)(4) of this section).

(ii) *Indirectly-held partnership interests*—(A) *Look through rule.* If an organization holds a direct interest in a partnership but that directly-held partnership interest is not a QPI because it does not meet the requirements of the de minimis test (described in paragraph (c)(3) of this section) or the participation test (described in paragraph (c)(4) of this section), any partnership in which the organization holds an indirect interest through the directly-held partnership interest (indirectly-held partnership interest) may be a QPI if the indirectly-held partnership interest meets the requirements of paragraph (c) (2)(ii)(B) or (c)(2)(ii)(C) of this section.

(B) *Indirectly-held partnership interests that meet the requirements of the de minimis test.* An indirectly-held partnership interest meets the requirements of this paragraph (c)(2)(ii)(B) if the indirectly-held partnership interest meets the requirements of the de minimis test described in paragraph (c)(3) of this section with regard to the organization. For example, if an organization directly holds 50 percent of the capital interests of a partnership and the directly-held partnership holds 4 percent of the capital and profits interest of lower-tier partnership A, the organization may aggregate its interest in lower-tier partnership A with its other QPIs because the organization indirectly holds 2 percent of the capital and profits interests of lower-tier partnership A (4 percent x 50 percent).

(C) *Indirectly-held partnership interests that meet the requirements of the participation test.* An indirectly-held partnership interest meets the requirements of this paragraph (c)(2)(ii)(C) if the indirectly-held partnership interest meets the requirements of the participation test (described in paragraph (c)(4) of this section) with respect to the partnership that directly owns the interest in the indirectly-held partnership. For purposes of applying the participation test to a partnership, the term *organization* in paragraph (c)(4) of this section refers to the partnership that directly holds the indirectly-held partner-

ship interest being tested for QPI status. Additionally, the list of officers, directors, trustees, or employees of an organization found in paragraphs (c)(4)(iii)(B) and (C) includes a general partner that directly owns an interest in the lower-tier partnership.

(D) *Example*—(1) Organization D is described in section 501(c) and is exempt from Federal income tax under section 501(a). Organization D owns 50 percent of the capital interest in Partnership A. Partnership A owns 30 percent of the capital interest in Partnership B, but Partnership A does not significantly participate in Partnership B within the meaning of paragraph (c)(4)(iii) of this section. Further, Partnership B owns 15 percent of the capital interest in Partnership C, in which Partnership B does not significantly participate within the meaning of paragraph (c)(4)(iii) of this section. No other organizations related (within the meaning of paragraph (c)(4)(ii) of this section) to either Organization D or the partnerships owns an interest in any of the lower-tier partnerships.

(2) Neither the interest in Partnership A nor B is a QPI. Organization D's interest in Partnership A does not meet the requirements of either the de minimis test or the participation test because it owns 50 percent of the interest in the partnership. Organization D's indirect interest in Partnership B (50 percent of 30 percent, or 15 percent) does not meet the de minimis test. Additionally, because Partnership A owns greater than 20 percent interest in Partnership B, Partnership A's interest in Partnership B does not meet the participation test. However, Organization D's interest in Partnership C is a QPI because Partnership C meets the participation test. That is, Partnership B holds a 15 percent interest in Partnership C and does not significantly participate in Partnership C.

(iii) *Designation.* An organization that has a partnership interest meeting the requirements of paragraph (c)(2)(i) or (ii) of this section in a taxable year may designate that partnership interest as a QPI by including its share of partnership gross income (and directly connected deductions) with the gross income (and directly connected deductions) from its other investment activities (see paragraph (c)(1) of this section) in accordance with forms

and instructions. Any partnership interest that is designated as a QPI remains a QPI unless and until it no longer meets the requirements of paragraph (c)(2)(i) or (ii) of this section. For example, if an organization designates a directly-held partnership interest that meets the requirements of the de minimis rule as a QPI in one taxable year, the organization cannot, in the next taxable year, use NAICS 2-digit codes to describe the partnership trades or businesses that are unrelated trades or businesses with respect to the organization unless the directly-held partnership interest fails to meet the requirements of both the de minimis test and the participation test (after application of the grace period described in paragraph (c)(6) of this section, if appropriate).

(3) *De minimis test.* A partnership interest is a QPI that meets the requirements of the de minimis test if the organization holds directly (within the meaning of paragraph (c)(2)(i) of this section) or indirectly (within the meaning of paragraph (c)(2)(ii) of this section) no more than 2 percent of the profits interest and no more than 2 percent of the capital interest during the organization's taxable year with which or in which the partnership's taxable year ends.

(4) *Participation test—(i) In general.* A partnership interest is a QPI that meets the requirements of the participation test if the organization holds directly (within the meaning of paragraph (c)(2)(i) of this section) or indirectly (within the meaning of paragraph (c)(2)(ii) of this section) no more than 20 percent of the capital interest during the organization's taxable year with which or in which the partnership's taxable year ends and the organization does not significantly participate in the partnership within the meaning of paragraph (c)(4)(iii) of this section.

(ii) *Combining related interests.* When determining an organization's percentage interest in a partnership for purposes of paragraph (c)(4)(i) of this section, the interests of a supporting organization (as defined in section 509(a)(3) and §1.509(a)-4), other than a Type III supporting organization (as defined in §1.509(a)-4(i)) that is not a parent of its supported organization, or of a controlled entity (as defined in section 512(b)(13)(D) and §1.512(b)-1(l)) in the same partnership will be tak-

en into account. For example, if an organization owns 10 percent of the capital interests in a partnership, and its Type I supporting organization owns an additional 15 percent capital interest in that partnership, the organization would not meet the requirements of the participation test because its aggregate percentage interest exceeds 20 percent (10 percent + 15 percent = 25 percent).

(iii) *Significant Participation.* An organization significantly participates in a partnership if—

(A) The organization, by itself, may require the partnership to perform, or may prevent the partnership from performing (other than through a unanimous voting requirement or through minority consent rights), any act that significantly affects the operations of the partnership;

(B) Any of the organization's officers, directors, trustees, or employees have rights to participate in the management of the partnership at any time;

(C) Any of the organization's officers, directors, trustees, or employees have rights to conduct the partnership's business at any time; or

(D) The organization, by itself, has the power to appoint or remove any of the partnership's officers or employees or a majority of directors.

(5) *Determining percentage interest—*

(i) *Profits interest.* For purposes of the de minimis test described in paragraph (c)(3) of this section, an organization's profits interest in a partnership is determined in the same manner as its distributive share of partnership taxable income. See section 704(b) (relating to the determination of the distributive share by the income or loss ratio) and §§1.704-1 through 1.704-4.

(ii) *Capital interest.* For purposes of the de minimis test (described in paragraph (c)(3) of this section) and the participation test (described in paragraph (c)(4)(i) of this section), in the absence of a provision in the partnership agreement, an organization's capital interest in a partnership is determined on the basis of its interest in the assets of the partnership which would be distributable to such organization upon its withdrawal from the partnership, or upon liquidation of the partnership, whichever is the greater.

(iii) *Average percentage interest.* For purposes of the de minimis test (described

in paragraph (c)(3) of this section) and the participation test (described in paragraph (c)(4)(i) of this section), an organization determines its percentage interest by taking the average of the organization's percentage interest at the beginning and the end of the partnership's taxable year, or, in the case of a partnership interest held for less than a year, the percentage interest held at the beginning and end of the period of ownership within the partnership's taxable year. For example, if an organization acquires an interest in a partnership that files on a calendar year basis in May and the partnership reports on Schedule K-1 (Form 1065) that the partner held a 3 percent profits interest at the date of acquisition but held a 1 percent profits interest at the end of the calendar year, the organization will be considered to have held 2 percent of the profits interest in that partnership for that year ((3 percent + 1 percent)/2).

(iv) *Reliance on Schedule K-1 (Form 1065).* When determining the organization's average percentage interest (described in paragraph (c)(5)(iii) of this section) in a partnership for purposes of the de minimis test (described in paragraph (c)(3) of this section) and the participation test (described in paragraph (c)(4) of this section), an organization may rely on the Schedule K-1 (Form 1065) (or its successor) it receives from the partnership if the form lists the organization's percentage profits interest or its percentage capital interest, or both, at the beginning and end of the year. However, the organization may not rely on the form to the extent that any information about the organization's percentage interest is not specifically provided. For example, if the Schedule K-1 (Form 1065) an organization receives from a partnership lists the organization's profits interest as "variable" but lists its percentage capital interest at the beginning and end of the year, the organization may rely on the form only with respect to its percentage capital interest.

(6) *Changes in percentage interest.* A partnership interest that fails to meet the requirements of the de minimis test (described in paragraph (c)(3) of this section) or the participation test (described in paragraph (c)(4) of this section) because of an increase in percentage interest in the organization's current taxable year may be

treated for the taxable year of the change as meeting the requirements of the test it met in the prior taxable year if—

(i) The partnership interest met the requirements of the de minimis test or participation test, respectively, in the organization's prior taxable year without application of this paragraph (c)(6);

(ii) The increase in percentage interest is solely due to the actions of one or more partners other than the organization; and

(iii) In the case of a partnership interest that met the requirements of the participation test in the prior taxable year, the interest of the partner or partners that caused the increase in paragraph (c)(6)(ii) of this section was not combined for the prior taxable year and is not combined for the taxable year of the change with the organization's partnership interest for purposes of paragraph (c)(4)(ii) of this section.

(7) *UBTI from the investment activities of organizations subject to section 512(a)(3)*. For purposes of paragraph (c)(1) of this section, UBTI from the investment activities of an organization subject to section 512(a)(3) includes any amount that—

(i) Would be excluded from the calculation of UBTI under section 512(b)(1), (2), (3), or (5) if the organization were subject to section 512(a)(1);

(ii) Is attributable to income set aside (and not in excess of the set aside limit described in section 512(a)(3)(E)), but not used, for a purpose described in section 512(a)(3)(B)(i) or (ii); or

(iii) Is in excess of the set aside limit described in section 512(a)(3)(E).

(8) *Limitations*—(i) *Social clubs*. Paragraphs (c)(2) (regarding QPIs) and (c)(9) (transition rule for certain partnership interests) of this section do not apply to social clubs described in section 501(c)(7).

(ii) *General partnership interests*. Any partnership in which an organization, or an organization whose interest is combined with that organization's interest for purposes of paragraph (c)(4)(ii) of this section, is a general partner under applicable state law is not a QPI within the meaning of paragraph (c)(2) of this section, regardless of the organization's percentage interest. Such partnership interest cannot be a QPI for any organization or for any of the organizations whose interest is combined with that organization's interest for purposes of paragraph (c)(4)(ii) of this section.

(iii) *Application of other sections*. This paragraph (c) does not otherwise impact application of section 512(c) and the fragmentation rule under section 513(c).

(9) *Transition rule for certain partnership interests*—(i) *In general*. If a directly-held partnership interest acquired prior to August 21, 2018, is not a QPI, an organization may treat such partnership interest as a separate unrelated trade or business for purposes of section 512(a)(6) regardless of the number of unrelated trades or businesses directly or indirectly conducted by the partnership. For example, if an organization has a 35 percent capital interest in a partnership acquired prior to August 21, 2018, it can treat the partnership as a single trade or business even if the partnership's investments generated UBTI from lower-tier partnerships that were engaged in multiple trades or businesses. A partnership interest acquired prior to August 21, 2018, will continue to meet the requirement of this rule even if the organization's percentage interest in such partnership changes before the end of the transition period (see paragraph (c)(9)(iii) of this section).

(ii) *Exclusivity*. An organization may apply either the transition rule in paragraph (c)(9)(i) of this section or the look-through rule in paragraph (c)(2)(ii) of this section, but not both, to a partnership interest described in paragraph (c)(9)(i) of this section that also qualifies for application of the look-through rule described in paragraph (c)(2)(ii).

(iii) *Transition period*. An organization may rely on this transition rule until the first day of the organization's first taxable year beginning after December 2, 2020.

(d) *Income from certain controlled entities*—(1) *Specified payments from controlled entities*. If an organization (controlling organization) controls another entity (within the meaning of section 512(b)(13)(D)) (controlled entity), all specified payments (as defined in section 512(b)(13)(C)) received by a controlling organization from that controlled entity are treated as gross income from a separate unrelated trade or business for purposes of paragraph (a) of this section. If a controlling organization receives specified payments from two different controlled entities, the payments from each controlled entity are treated as a separate

unrelated trade or business. For example, a controlling organization that receives rental payments from two controlled entities has two separate unrelated trades or businesses, one for each controlled entity. The specified payments from a controlled entity are treated as gross income from one trade or business regardless of whether the controlled entity engages in more than one unrelated trade or business or whether the controlling organization receives more than one type of specified payment from that controlled entity.

(2) *Certain amounts derived from controlled foreign corporations*. All amounts included in UBTI under section 512(b)(17) are treated as income derived from a separate unrelated trade or business for purposes of paragraph (a) of this section.

(e) *S corporation interests*—(1) *In general*. Except as provided in paragraph (e)(2) of this section, if an organization owns stock in an S corporation (S corporation interest), such S corporation interest is treated as an interest in a separate unrelated trade or business for purposes of paragraph (a) of this section. Thus, if an organization owns two S corporation interests, neither of which is described in paragraph (e)(2) of this section, the exempt organization reports two separate unrelated trades or businesses, one for each S corporation interest. The UBTI from an S corporation interest is the amount described in section 512(e)(1)(B).

(2) *Exception for a qualifying S corporation interest*. Notwithstanding paragraph (e)(1) of this section, an organization may aggregate its UBTI from an S corporation interest with its UBTI from other investment activities (described in paragraph (c)(1) of this section) if the organization's ownership interest in the S corporation meets the criteria for a QPI as described in paragraph (c)(2)(i) of this section (substituting "S corporation" for "partnership" and "shareholder" or "shareholders" for "partner" or "partners," as applicable, throughout paragraphs (c)(2)(i), (c)(3), (c)(4), (c)(5)(iii), (c)(5)(iv), and (c)(6) of this section; "no more than 2 percent of stock ownership" for "no more than 2 percent of the profits interest and no more than 2 percent of the capital interest" in paragraph (c)(3) of this section; "no more than 20 percent of stock ownership" in place of "no more than 20 percent of the capi-

tal interest” in paragraph (c)(4)(i) of this section; and “Schedule K-1 (Form 1120-S)” for “Schedule K-1 (Form 1065)” for purposes of paragraph (c)(5)(iv) of this section). Paragraphs (c)(5)(i) and (c)(5)(ii) do not apply for purposes of determining an organization’s ownership interest in an S corporation; rather, the average percentage stock ownership determined under paragraph (c)(5)(iii) of this section applies for purposes of this paragraph (e) (2). For purposes of paragraph (c)(5)(iv) of this section, an organization can rely on the Schedule K-1 (Form 1120-S) (or its successor) it receives from the S corporation only if the form lists information sufficient to determine the organization’s percentage of stock ownership for the year. A Schedule K-1 (Form 1120-S) that reports “zero” as the organization’s number of shares of stock in either the beginning or end of the S corporation’s taxable year does not list information sufficient to determine the organization’s percentage of stock ownership for the year. The grace period described in paragraph (c) (6) of this section applies to changes in an exempt organization’s percentage of stock ownership in an S corporation.

(f) *Allocation of deductions.* An organization must allocate deductions between separate unrelated trades or businesses using the method described in §1.512(a)-1(c).

(g) *Total UBTI*—(1) *In general.* The total UBTI of an organization with more than one unrelated trade or business is the sum of the UBTI computed with respect to each separate unrelated trade or business (as identified under paragraph (a)(2) of this section and subject to the limitation described in paragraph (g)(2) of this section), less a charitable contribution deduction, an NOL deduction for losses arising in taxable years beginning before January 1, 2018 (pre-2018 NOLs), and a specific deduction under section 512(b)(12), as applicable.

(2) *UBTI not less than zero.* For purposes of paragraph (g)(1) of this section, the UBTI with respect to any separate unrelated trade or business identified under paragraph (a)(2) of this section cannot be less than zero.

(h) *Net operating losses*—(1) *In general.* For taxable years beginning after December 31, 2017, an exempt organiza-

tion with more than one unrelated trade or business determines the NOL deduction allowed by sections 172(a) and 512(b)(6) separately with respect to each of its unrelated trades or businesses. Accordingly, if an exempt organization has more than one unrelated trade or business, §1.512(b)-1(e) applies separately with respect to each such unrelated trade or business.

(2) *Coordination of pre-2018 and post-2017 NOLs.* An organization with pre-2018 NOLs, and with losses arising in a taxable year beginning after December 31, 2017 (post-2017 NOLs), deducts its pre-2018 NOLs from total UBTI before deducting any post-2017 NOLs with regard to a separate unrelated trade or business against the UBTI from such trade or business. Pre-2018 NOLs are taken against the total UBTI as determined under paragraph (g) of this section in a manner that allows for maximum utilization of post-2017 NOLs in a taxable year. For example, an organization could choose to allocate all of its pre-2018 NOLs to one of its separate unrelated trades or businesses or it could allocate its pre-2018 NOLs ratably among its separate unrelated trades or businesses, whichever results in the greatest utilization of the post-2017 NOLs in that taxable year.

(3) *Treatment of NOLs upon the termination, sale, exchange, or other disposition of a separate unrelated trade or business.* After offsetting any gain resulting from the termination, sale, exchange, or disposition of a separate unrelated trade or business, any NOL remaining is suspended. However, the suspended NOLs may be used if that previous separate unrelated trade or business is later resumed or if a new unrelated trade or business that is accurately identified using the same NAICS 2-digit code as the previous separate unrelated trade or business is commenced or acquired in a future taxable year.

(4) *Treatment of NOLs when the identification of a separate unrelated trade or business changes*—(i) *In general.* For purposes of section 512(a)(6) and this section, a separate unrelated trade or business for which the appropriate identification (within the meaning of paragraph (a) of this section) changes is treated as if the originally identified separate unrelated trade or business is terminated and a new separate unrelated trade or business is commenced. None of the NOLs from the

previously identified separate unrelated trade or business will be carried over to the newly identified separate unrelated trade or business. For example, if the nature of a separate unrelated trade or business changes such that it is more accurately described by another NAICS 2-digit code, the separate unrelated trade or business is treated as a new separate unrelated trade or business with no NOLs. The change in identification may apply to all or a part of the originally identified separate unrelated trade or business. If the change in identification applies to the originally identified separate trade or business in its entirety, any NOLs attributable to that separate unrelated trade or business are suspended in accordance with paragraph (h)(3) of this section. If the change in identification applies to the originally identified separate unrelated trade or business in part, the originally identified separate unrelated trade or business that is not changing retains the full NOLs attributable to the originally identified separate unrelated trade or business, without allocation to the portion that became a newly identified separate unrelated trade or business. This paragraph (h)(4) also applies to each QPI that becomes a non-QPI. In this case, any NOLs attributable to the QPI that became a non-QPI are retained with the organization’s investment activities described in paragraph (c) of this section.

(ii) *Exception for non-material changes.* In the case of a separate unrelated trade or business that is accidentally identified using the wrong NAICS 2-digit code or if an organization has determined that a separate unrelated trade or business that has not materially changed is more accurately identified by another NAICS 2-digit code, any NOL attributable to the originally identified separate unrelated trade or business becomes an NOL of the newly identified separate unrelated trade or business.

(iii) *Effective date of change in identification.* A change in identification described in this paragraph (h)(4) is effective on the first day of the taxable year in which the change in identification is made. Accordingly, the newly identified separate unrelated trade or business is treated as commencing on this date.

(iv) *Examples*—(A) *In general.* The following examples illustrate the rules described in this paragraph (h)(4).

(B) *Example 1. Erroneous code*—(1) Organization G is described in section 501(c) and is exempt from Federal income tax under section 501(a). In addition to its investment activities, Organization G has two separate unrelated trades or businesses – Q and R – that are identified with different NAICS 2-digit codes. Both Q and R have NOLs carried over from post-2017 taxable years.

(2) In Year 2 (a post-2017 taxable year), Organization G realizes that it accidentally used the wrong NAICS 2-digit code to identify R. The NOLs attributable to R under the old NAICS 2-digit code become the NOLs of R under the new NAICS 2-digit code as of the first day of Year 2.

(C) *Example 2. Material change*—(1) Same facts as *Example 1*, except assume that, in addition to its investment activities, Organization G has three separate unrelated trades or businesses – Q, R, and S – that are identified with different NAICS 2-digit codes. Q, R, and S all have NOLs carried over from post-2017 taxable years.

(2) Organization G changes the NAICS 2-digit code identifying R to the same NAICS 2-digit code identifying S because the nature of the unrelated trade or business materially changed. Any post-2017 NOLs attributable to R are suspended (see paragraph (h)(4)(i) of this section). Organization G now has two separate unrelated trades or businesses – Q and S – as of the first day of Year 2.

(D) *Example 3. Partial material change*. Same facts as *Example 1*, except assume that Organization G determines that a part of R has materially changed such that R should be identified as two separate unrelated trades or businesses – R1 and R2. R1 retains the NAICS 2-digit code originally identifying R, and R2 is identified with a new NAICS 2-digit code that is not the same NAICS 2-digit code identifying Q. R2 is treated as a new separate unrelated trade or business with no NOLs as of the first day of Year 2. Any post-2017 NOLs attributable to R remain with R1.

(E) *Example 4. QPI to non-QPI*—(1) Same facts as *Example 1*, but assume that Organization G has a partnership interest in T that was, for prior taxable years, a QPI included with Organization G's investment activities. In Year 3 (a post-2017 taxable year), Organization G acquires

more than 20 percent of the capital interests in T. The grace period described in paragraph (c)(6) of this section does not apply because the increase in percentage interest was not due to the actions of other partners.

(2) T conducts two trade or business activities that are unrelated trade or business activities with respect to Organization G – T1 and T2. Both T1 and T2 will be treated as new separate unrelated trades or business as of the first day of Year 2. Organization G identifies T1 with the same NAICS 2-digit code used to identify Q and T2 with a NAICS 2-digit code that is different than the NAICS 2-digit codes used to identify Q and R. In addition to its investment activities, Organization G has three separate unrelated trades or businesses – Q, R, and T2. Any post-2017 NOLs attributable to the QPI remain with Organization G's other investment activities separate unrelated trade or business.

(i) *Applicability dates*. This section is applicable to taxable years beginning on or after December 2, 2020. Taxpayers may choose to apply this section to taxable years beginning on or after January 1, 2018, and before December 2, 2020.

Par. 6. Section 1.512(b)-1 is amended by:

1. Revising paragraph (a)(1).
2. Adding a sentence to the end of paragraph (a)(3).
3. Adding paragraph (e)(5).
4. Adding paragraphs (g)(4) and (5).

The revisions and additions read as follows:

§1.512(b)-1 Modifications.

(a) * * *

(1) * * * Dividends (including an inclusion of subpart F income under section 951(a)(1)(A) or an inclusion of global intangible low-taxed income (GILTI) under section 951A(a), both of which are treated in the same manner as a dividend for purposes of section 512(b)(1)), interest, payments with respect to securities loans (as defined in section 512(a)(5)), annuities, income from notional principal contracts (as defined in §1.837-7 or regulations issued under section 446), other substantially similar income from ordinary and routine investments to the extent

determined by the Commissioner, and all deductions directly connected with any of the foregoing items of income must be excluded in computing unrelated business taxable income.

* * * * *

(3) * * * The exclusion under paragraph (a)(1) of this section of an inclusion of subpart F income under section 951(a)(1)(A) or an inclusion of GILTI under section 951A(a) from income (both inclusions being treated in the same manner as dividends) is applicable to taxable years beginning on or after December 2, 2020. However, an organization may choose to apply this exclusion to taxable years beginning before December 2, 2020.

* * * * *

(e) * * *

(5) See §1.512(a)-6(h) regarding the computation of the net operating loss deduction when an organization has more than one unrelated trade or business.

* * * * *

(g) * * *

(4) The term *unrelated business taxable income* as used in section 512(b)(10) and (11) refers to unrelated business taxable income after application of section 512(a)(6).

(5) Paragraph (g)(4) of this section is applicable to taxable years beginning on or after December 2, 2020. Taxpayers may choose to apply this section to taxable years beginning on or after January 1, 2018, and before December 2, 2020.

* * * * *

Par. 7. Section 1.513-1 is amended by:

1. Revising the third and fourth sentence in paragraph (a).
2. Redesignating paragraphs (f) and (g) as paragraphs (g) and (h).
3. Adding new paragraph (f).
4. Adding a sentence to the end of newly redesignated paragraph (h).

The revisions and additions read as follows:

§1.513-1 Definition of unrelated trade or business.

(a) * * * For certain exceptions from this definition, see paragraph (e) of this section. For a special definition of *unrelated trade or business* applicable to certain trusts, see paragraph (f) of this section. * * *

* * * * *

(f) *Special definition of “unrelated trade or business” for trusts.* In the case of a trust computing its unrelated business taxable income under section 512 for purposes of section 681, or a trust described in section 401(a) or section 501(c)(17), which is exempt from tax under section 501(a), section 513(b) provides that the term *unrelated trade or business* means any trade or business regularly carried on by such trust or by a partnership of which it is a member. This definition also applies to an individual retirement account described in section 408 that, under section 408(e), is subject to the tax imposed by section 511.

* * * * *

(h) * * * Paragraph (f) of this section applies to taxable years beginning on or after December 2, 2020.

Sunita Lough,
*Deputy Commissioner for Services
and Enforcement.*

Approved: November 13, 2020.

David J. Kautter,
*Assistant Secretary of the Treasury
(Tax Policy).*

(Filed by the Office of the Federal Register on November 30, 2020, 4:14 p.m., and published in the issue of the Federal Register for December 02, 2020, 85 FR 77952)

26 CFR 1.245A-6 through 26 CFR 1.245A-11; 26 CFR 1.951A-2; 26 CFR 1.6038-2

T.D. 9934

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Coordination of Extraordinary Disposition and Disqualified Basis Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under sections 245A and 951A of the Internal Revenue Code (the “Code”) that coordinate the extraordinary disposition rule under section 245A of the Code with the disqualified basis and disqualified payment rules under section 951A of the Code. This document also contains final regulations under section 6038 of the Code regarding information reporting to facilitate administration of the final regulations. The final regulations affect corporations that are subject to the extraordinary disposition rule and the disqualified basis rule or the disqualified payment rule. This document finalizes proposed regulations published on August 27, 2020.

DATES: *Effective date:* These regulations are effective on January 12, 2021.

Applicability dates: For dates of applicability, see §§ 1.245A-11 and 1.6038-2(m) (5).

FOR FURTHER INFORMATION CONTACT: Logan M. Kincheloe, (202) 317-6937 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 27, 2020, the Department of the Treasury (“Treasury Department”) and the IRS published proposed regulations (REG-124737-19) under sections 245A, 951A, and 6038 in the **Federal Register** (85 FR 53098) (the “proposed regulations”).

The Treasury Department and the IRS received one written comment with respect to the proposed regulations; however, the comment was not substantively related to, and did not suggest any revisions to, the proposed regulations. Therefore, this preamble does not address the comment. The written comment is available at www.regulations.gov or upon request. A public hearing on the proposed regulations was not held because there were no requests to speak.

This document contains amendments to 26 CFR part 1 under sections 245A, 951A, and 6038 (the “final regulations”). Any term used but not defined in this pre-

amble has the meaning given to it in the final regulations or the preamble to the proposed regulations.

The effective date of these regulations is delayed until January 12, 2021, to provide for the orderly amendment of §1.951A-2 by TD 9922, 85 FR 71998, published on November 12, 2020, and with a delayed effective date of January 11, 2021. The changes to §1.951A-2 made in these regulations are to the regulation text as amended by TD 9922.

Explanation of Revisions

I. Overview

The extraordinary disposition rule and the disqualified basis rule generally address certain transactions, involving related controlled foreign corporations (“CFCs”) of a section 245A shareholder, that were not subject to current U.S. tax solely by reason of having occurred during the disqualified period. In general, as to the section 245A shareholder, the extraordinary disposition rule ensures that earnings and profits generated by such a transaction are subject to U.S. tax when distributed as a dividend, and the disqualified basis rule ensures that basis generated by the transaction does not offset or reduce income that would otherwise be subject to U.S. tax at the section 245A shareholder-level under section 951(a)(1) (A) or 951A(a), or at the CFC-level under section 882(a) (that is, as income effectively connected with the conduct of a trade or business in the United States). See §§1.245A-5 and 1.951A-2(c)(5).

Absent a coordination mechanism, the extraordinary disposition rule and the disqualified basis rule could give rise to excess taxation as to a section 245A shareholder, because the earnings and profits to which the extraordinary disposition rule applies (“extraordinary disposition E&P”), and the basis to which the disqualified basis rule applies (“disqualified basis”), are generally a function of a single amount of gain. The proposed regulations coordinate the extraordinary disposition rule and the disqualified basis rule through two operative rules: the DQB reduction rule, which reduces disqualified basis in certain cases, and the EDA reduction rule, which reduces an extraordinary disposition account in

certain cases. *See* proposed §§1.245A-7 and 1.245A-8. These operative rules also apply to coordinate the extraordinary disposition rule and the disqualified payment rule, which addresses transactions similar to those to which the disqualified basis rule applies.

This rulemaking finalizes the proposed regulations, with one revision, as discussed in part II of this Explanation of Revisions.

II. The DQB Reduction Rule – Treatment of Prior Extraordinary Disposition Amounts

Under the proposed regulations, the DQB reduction rule generally applies when, as to a section 245A shareholder, extraordinary disposition E&P become subject to U.S. tax by reason of the application of the extraordinary disposition rule to a distribution of the extraordinary disposition E&P. *See* proposed §§1.245A-7(b) and 1.245A-8(b). In general, the DQB reduction rule provides that basis attributable to gain to which the extraordinary disposition E&P are also attributable is no longer disqualified basis. *Id.*

The preamble to the proposed regulations noted that the Treasury Department and the IRS were studying whether the DQB reduction rule should also apply by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(I)(i) through (iv). The preamble requested comments on this matter, but none were received. Such a prior extraordinary disposition amount generally represents extraordinary disposition E&P that have become subject to U.S. tax as to a section 245A shareholder other than by direct application of the extraordinary disposition rule – for example, extraordinary disposition E&P that give rise to an in-

come inclusion to the section 245A shareholder by reason of sections 951(a)(1)(B) and 956(a). Under the extraordinary disposition rule, the application of the other provision to the extraordinary disposition E&P results in a reduction to the application of the extraordinary disposition rule, because otherwise the earnings and profits (or an amount of other earnings and profits) could be taxed as to the section 245A shareholder both by reason of the other provision and the extraordinary disposition rule. *See* §1.245A-5(c)(3)(i)(D). This reduction to the application of the extraordinary disposition rule will generally result in an extraordinary disposition being subject to a single level of U.S. tax.

The Treasury Department and the IRS have determined that the DQB reduction rule should also apply by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(I)(i) through (iv), and therefore the final regulations provide a rule to this effect. *See* §§1.245A-7(b)(3) and 1.245A-8(b)(6). Absent such an approach, gain to which extraordinary disposition E&P and disqualified basis are attributable could in effect be taxed both by reason of the disqualified basis rule and a provision other than the extraordinary disposition rule.

Applicability Dates

The final regulations apply to taxable years of foreign corporations beginning on or after December 1, 2020, and to taxable years of section 245A shareholders in which or with which such taxable years of foreign corporations end. *See* §1.245A-11(a). In addition, taxpayers may choose to apply the final regulations to taxable years beginning before December 1, 2020, subject to certain limitations. *See* §1.245A-11(b).

Special Analyses

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

I. Paperwork Reduction Act (“PRA”)

The collections of information in the final regulations are in §1.6038-2(f)(17) and (18). Under the PRA (44 U.S.C. 3501 et seq.), 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 OMB control number.

The collection of information in §1.6038-2(f)(17) is mandatory for every U.S. shareholder of a CFC that holds an item of property that has disqualified basis within the meaning of §1.951A-3(h)(2) during an annual accounting period and files Form 5471 for that period (OMB control number 1545-0123). The collection of information in §1.6038-2(f)(17) is satisfied by providing information about the items of property with disqualified basis held by the CFC during the CFC’s accounting period as Form 5471 and its instructions may prescribe. For purposes of the PRA, the reporting burden associated with §1.6038-2(f)(17) will be reflected in the applicable PRA submission associated with Form 5471. As provided below, the estimated number of respondents for the reporting burden associated with §1.6038-2(f)(17) is 7,500-8,500, based on estimates provided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

	New	Revision of existing form	Number of respondents (estimate)
Schedule to Form 5471		✓	7,500-8,500

The collection of information in §1.6038-2(f)(18) is mandatory for every U.S. shareholder of a CFC that applies the rules of §§1.245A-6 through 1.245A-11 during an annual accounting period and files Form 5471 for that period (OMB control number 1545-0123). The collection of information

in §1.6038-2(f)(18) is satisfied by providing information about the reduction to an extraordinary disposition account made pursuant to §1.245A-7(b) or §1.245A-8(b) and reductions to an item of specified property’s disqualified basis pursuant to §1.245A-7(c) or §1.245A-8(c) during the corporation’s

accounting period as Form 5471 and its instructions may prescribe. For purposes of the PRA, the reporting burden associated with §1.6038-2(f)(18) will be reflected in the applicable PRA submission associated with Form 5471. As provided below, the estimated number of respondents for the re-

porting burden associated with §1.6038-2(f) (18) is 7,500-8,500, based on estimates pro-

vided by the Research, Applied Analytics and Statistics Division of the IRS.

The related new or revised tax form is as follows:

	New	Revision of existing form	Number of respondents (estimate)
Schedule to Form 5471		✓	7,500-8,500

The current status of the PRA submissions related to the new revised Form 5471 as a result of the information collections in the final regulations is provided in the accompanying table. The reporting burdens associated with the information collections in § 1.6038-2(f)(17) and (18) are included in the aggregated burden estimates for OMB control number 1545-0123, which represents a total estimated burden time for all forms and schedules for corporations of 3.157 billion hours and total estimated monetized costs of \$58.148 billion (\$2017). The overall burden estimates provided in 1545-0123 are aggregate

amounts that relate to the entire package of forms associated with the OMB control number and will in the future include but not isolate the estimated burden of the tax forms that will be revised as a result of the information collections in the final regulations. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and the IRS urge readers to recognize that these numbers are duplicates of estimates provided for informational purposes in other proposed and final regulatory actions and to guard against over-counting

the burden that international tax provisions imposed before the Act.

No burden estimates specific to the final regulations are currently available. The Treasury Department and the IRS have not identified any burden estimates, including those for new information collections, related to the requirements under the final regulations. Proposed revisions to these forms that reflect the information collections contained in these final regulations will be made available for public comment at www.irs.gov/draftforms and will not be finalized until after approved by OMB under the PRA.

Information Collection	Type of Filer	OMB Number(s)	Status
Form 5471	Business (NEW Model)	1545-0123	Published in the Federal Register on 9/30/19. Public Comment period closed on 11/29/19. Approved by OMB through 1/31/2021.
			https://www.federalregister.gov/documents/2019/09/30/2019-21068/proposed-collection-comment-request-for-forms-1065-1066-1120-1120-c-1120-f-1120-h-1120-nd-1120-s

II. Regulatory Flexibility Act

It is hereby certified that this rulemaking will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). The small entities that are subject to §1.245A-5 are small entities that are U.S. shareholders of certain foreign corporations that are otherwise eligible for the section 245A deduction on distributions from the foreign corporation. The small entities that are subject to §1.951A-2(c)(5) are U.S. shareholders of certain foreign corporations that are subject to tax under section 951 with respect to subpart F income of those foreign corporations or section 951A with respect to tested income of those foreign corporations.

The taxpayers potentially affected by these final regulations are U.S. sharehold-

ers of at least two related foreign corporations, one that has an extraordinary disposition account and the other that has assets with disqualified basis corresponding to the extraordinary disposition account. This means that the foreign corporation with the extraordinary disposition account has or had a fiscal year and engaged in a disposition of property (i) during the period between January 1, 2018, and the end of the transferor foreign corporation's last taxable year beginning before 2018; (ii) outside the ordinary course of the foreign corporation's activities; and (iii) generally, while the corporation was a CFC.

The Treasury Department and the IRS have not estimated how many taxpayers are likely to be affected by these regulations because data on the taxpayers that may have engaged in these particular transactions are not readily available. Based on tabulations of the 2014 Statistics of Income Study file the Treasury

Department and the IRS estimate that there are approximately 5,000 domestic corporations with at least one fiscal year CFC. Previous estimates suggest that approximately half of domestic corporations with CFCs have less than \$25 million in gross receipts. However, the number of potentially affected taxpayers is smaller than the number of domestic corporations with at least one fiscal year CFC because a domestic corporation will not be affected unless its fiscal year CFC engages in a non-routine sale with a related party that creates an extraordinary disposition account and disqualified basis, and the domestic corporation must then incur the type of cost (limitation of the section 245A deduction or allocation of deductions or losses to residual CFC gross income and reduction in untaxed earnings) that causes these final regulations to apply. There are several industries that may be identified as small even

through their annual receipts are above \$25 million or because they have fewer employees than the SBA Size Standard for that industry. The Treasury Department and the IRS do not have more precise data indicating the number of small entities that will be potentially affected by the regulations. The rule may affect a substantial number of small entities, but data are not readily available to assess how many entities will be affected. Nevertheless, for the reasons described below, the Treasury Department and the IRS have determined that the regulations will not have a significant economic impact on small entities.

The Treasury Department and the IRS have concluded that there is no significant economic impact on such entities as a result of the final regulations. To make this determination, the Treasury Department and the IRS calculated the ratio of estimated global intangible lowed-taxed income (“GILTI”) and subpart F income tax attributable to these businesses to aggregate total sales data. Bureau of Economic Analysis data on the activities of multinational enterprises report total sales of all foreign affiliates of U.S. parents of \$7,183 billion in 2017 (accessed at this web address in December, 2018: <https://apps.bea.gov/iTable/iTable.cfm?ReqID=2&step=1>). Projections for GILTI and Subpart F tax revenues average \$20 billion per year over the ten-year budget window (see Joint Committee on Taxation, Estimated Budget Effects of the Conference Agreement for H.R. 1, The “Tax Cuts and Jobs Act, JCX-67-17, December 18, 2017), resulting in a less than 1 percent share of GILTI and Subpart F tax in total sales of U.S.-parented affiliates. Compliance costs for these regulations will be a small fraction of the revenue amounts. Thus, any tax regulation that affects the proceeds from GILTI and subpart F income would have an economic impact of less than 3 to 5 percent of “receipts” (as that term is defined in 13 CFR 121.104, the provision for calculating small business receipts, to mean sales and any other measure of gross income), an economic impact that the Treasury Department and IRS regard as the threshold for significant under the Regulatory Flexibility Act. This calculated percentage is furthermore an upper bound on the true

expected effect of the final regulations because not all the GILTI and subpart F income estimated to be attributable to small entities will be affected by the final regulations. For example, GILTI and subpart F income that is not attributable to a CFC that holds property with disqualified basis (or property that would otherwise have disqualified basis in the absence of these regulations) is not affected by these final regulations. Consequently, the Treasury Department and the IRS have determined that these final regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, the proposed regulations (REG-124737-19) preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses, and no comments were received.

III. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. These regulations do not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

IV. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These regulations do not have federalism implications and do not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Drafting Information

The principal author of the final regulations is Logan M. Kincheloe, Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

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 in numerical order for §§ 1.245A-6 through 1.245A-11 to read in part as follows:

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

Sections 1.245A-6 through 1.245A-11 also issued under 26 U.S.C. 245A(g), 882(c)(1)(A), 951A, 954(b)(5), 954(c)(6), and 965(o).

* * * * *

Par. 2. Section 1.245A-5 is amended by:

1. In the first sentence of paragraph (c)(3)(i)(A), adding immediately after the language “by the prior extraordinary disposition amount” the language “and as provided in §1.245A-7 or §1.245A-8”.

2. Revising paragraph (j)(8)(ii).

The revision reads as follows:

§1.245A-5 Limitation of section 245A deduction and section 954(c)(6) exception.

* * * * *

(j) * * *

(8) * * *

(ii) *Analysis.* Because the royalty prepayment was carried out with a principal purpose of avoiding the purposes of this section, appropriate adjustments are required to be made under the anti-abuse rule in paragraph (h) of this section. CFC1 is a CFC that has a November 30 taxable year, so under paragraph (c)(3)(iii) of this section, CFC1 has a disqualified period

beginning on January 1, 2018, and ending on November 30, 2018. In addition, even though the intangible property licensed by CFC1 to CFC2 is specified property, CFC2's prepayment of the royalty would not be treated as a disposition of the specified property by CFC1 and, therefore, would not constitute an extraordinary disposition (and thus would not give rise to extraordinary disposition E&P), absent the application of the anti-abuse rule of paragraph (h) of this section. Pursuant to paragraph (h) of this section, the earnings and profits of CFC1 generated as a result of the \$100x of prepaid royalty are treated as extraordinary disposition E&P for purposes of this section and, therefore, US1 has an extraordinary disposition account with respect to CFC1 of \$100x. In addition, the prepaid royalty gives rise to a disqualified payment (as defined in §1.951A-2(c)(6)(ii)(A)) of \$100x. As a result, §1.245A-7(b) or §1.245A-8(b), as applicable, applies to reduce the disqualified payment in the same manner as if the disqualified payment were disqualified basis, and §1.245A-7(c) or §1.245A-8(c), as applicable, applies to reduce the extraordinary disposition account in the same manner as if the deductions directly or indirectly related to the disqualified payment were deductions attributable to disqualified basis of an item of specified property that corresponds to the extraordinary disposition account.

* * * * *

Par. 3. Sections 1.245A-6 through 1.245A-11 are added to read as follows:
Sec.

* * * * *

1.245A-6 Coordination of extraordinary disposition and disqualified basis rules.

1.245A-7 Coordination rules for simple cases.

1.245A-8 Coordination rules for complex cases.

1.245A-9 Other rules and definitions.

1.245A-10 Examples.

1.245A-11 Applicability dates.

* * * * *

(a) *Scope.* This section and §§1.245A-7 through 1.245A-11 coordinate the application of the extraordinary disposition rules of §1.245A-5(c) and (d) and the disqualified basis rule of §1.951A-2(c)(5).

Section 1.245A-7 provides coordination rules for simple cases, and §1.245A-8 provides coordination rules for complex cases. Section 1.245A-9 provides definitions and other rules, including rules of general applicability for purposes of this section and §§1.245A-7 through 1.245A-11. Section 1.245A-10 provides examples illustrating the application of this section and §§1.245A-7 through 1.245A-9. Section 1.245A-11 provides applicability dates.

(b) *Conditions to apply coordination rules for simple cases.* For a taxable year of a section 245A shareholder for which the conditions described in paragraphs (b) (1) and (2) of this section are satisfied, the section 245A shareholder may apply the coordination rules of §1.245A-7 (rules for simple cases) to an extraordinary disposition account of the section 245A shareholder with respect to an SFC and disqualified basis of an item of specified property that corresponds to the extraordinary disposition account (as determined pursuant to §1.245A-9(b)(1)). If the conditions are not satisfied, then the coordination rules of §1.245A-8 (rules for complex cases) apply beginning with the first day of the first taxable year of the section 245A shareholder for which the conditions are not satisfied and all taxable years thereafter. If the conditions are satisfied for a taxable year of the section 245A shareholder but the section 245A shareholder chooses not to apply the coordination rules of §1.245A-7 for that taxable year, then the coordination rules of §1.245A-8 apply to that taxable year (though, for a subsequent taxable year, the section 245A shareholder may apply the coordination rules of §1.245A-7, provided that the conditions described in paragraphs (b)(1) and (2) of this section are satisfied for such subsequent taxable year and have been satisfied for all earlier taxable years). For purposes of applying paragraphs (b)(1) and (2) of this section, a reference to a section 245A shareholder, an SFC, or a CFC does not include a successor of the section 245A shareholder, the SFC, or the CFC, respectively.

(1) *Requirements related to the SFC.* The condition of this paragraph (b)(1) is satisfied for a taxable year of the section 245A shareholder if the following requirements are satisfied:

(i) On January 1, 2018, the section 245A shareholder owns (within the meaning of section 958(a)) all of the stock (by vote and value) of the SFC.

(ii) On each day of the taxable year of the section 245A shareholder, the section 245A shareholder owns (within the meaning of section 958(a)) all of the stock (by vote and value) of the SFC.

(iii) On no day during the taxable year of the section 245A shareholder was the SFC a distributing or controlled corporation in a transaction described in a section 355, or did the SFC acquire the assets of a corporation as to which there is an extraordinary disposition account pursuant to a transaction described in section 381 (that is, taking into account the requirements of this paragraph (b)(1) and paragraph (b)(2) of this section, the section 245A shareholder's extraordinary disposition account with respect to the SFC has not been not been adjusted pursuant to the rules of §1.245A-5(c)(4)).

(2) *Requirements related to an item of specified property that corresponds to an extraordinary disposition account and a CFC holding the item.* The condition of this paragraph (b)(2) is satisfied for a taxable year of a section 245A shareholder if the following requirements are satisfied:

(i) For each item of specified property with disqualified basis that corresponds to the extraordinary disposition account, the item of specified property is held by a CFC immediately after the extraordinary disposition of the item of specified property.

(ii) For each CFC described in paragraph (b)(2)(i) of this section—

(A) All of the stock (by vote and value) of the CFC is owned (within the meaning of section 958(a)) by the section 245A shareholder and any domestic affiliates of the section 245A shareholder immediately after the extraordinary disposition described in paragraph (b)(2)(i) of this section;

(B) For each taxable year of the CFC that ends with or within the taxable year of the section 245A shareholder, there is no extraordinary disposition account with respect to the CFC, and the sum of the balance of the hybrid deduction accounts (as described in §1.245A(e)-1(d)(1)) with respect to shares of stock of the CFC is zero (determined as of the end of the taxable

year of the CFC and taking into account any adjustments to the accounts for the taxable year); and

(C) On each day of each taxable year of the CFC that ends with or within the taxable year of the section 245A shareholder, and on each day of each taxable year of the CFC that begins with or within the taxable year of the section 245A shareholder—

(1) The CFC holds the item of specified property described in paragraph (b)(1)(i) of this section;

(2) The section 245A shareholder and any domestic affiliates own (within the meaning of section 958(a)) all of the stock (by vote and value) of the CFC;

(3) The CFC does not hold any item of specified property with disqualified basis other than an item of specified property that corresponds to the extraordinary disposition account;

(4) The CFC does not own an interest in a partnership, trust, or estate (directly or indirectly through one or more other partnerships, trusts, or estates) that holds an item of specified property with disqualified basis; and

(5) The CFC is not engaged in the conduct of a trade or business in the United States and therefore does not have ECTI, and the CFC does not have any deficit in earnings and profits subject to §1.381(c)(2)-1(a)(5).

§1.245A-7 Coordination rules for simple cases.

(a) *Scope.* This section applies for a taxable year of a section 245A shareholder for which the conditions of §1.245A-6(b)(1) and (2) are satisfied and for which the section 245A shareholder chooses to apply this section (in lieu of §1.245A-8).

(b) *Reduction of disqualified basis by reason of an extraordinary disposition amount or tiered extraordinary disposition amount—*(1) *In general.* If, for a taxable year of a section 245A shareholder, an extraordinary disposition account of the section 245A shareholder gives rise to one or more extraordinary disposition amounts or tiered extraordinary disposition amounts, then, with respect to an item of specified property that corresponds to the extraordinary disposition account, the disqualified basis of the item of specified property is, solely for purposes of

§1.951A-2(c)(5), reduced (but not below zero) by an amount (determined in the functional currency in which the extraordinary disposition account is maintained) equal to the product of—

(i) The sum of the extraordinary disposition amounts and the tiered extraordinary disposition amounts; and

(ii) A fraction, the numerator of which is the disqualified basis of the item of specified property, and the denominator of which is the sum of the disqualified basis of each item of specified property that corresponds to the extraordinary disposition account.

(2) *Timing rules regarding disqualified basis.* See §1.245A-9(b)(2) for timing rules regarding the determination of, and reduction to, disqualified basis of an item of specified property.

(3) *Special rule regarding prior extraordinary disposition amounts.* For purposes of paragraph (b)(1) of this section, to the extent that an extraordinary disposition account of a section 245A shareholder is reduced under §1.245A-5(c)(3)(i)(A) by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(I)(i) through (iv), the extraordinary disposition account is considered to give rise to an extraordinary disposition amount or tiered extraordinary disposition amount (and the amount by which the account is reduced is treated as an extraordinary disposition amount or tiered extraordinary disposition amount).

(c) *Reduction of extraordinary disposition account by reason of the allocation and apportionment of deductions or losses attributable to disqualified basis—*

(1) *In general.* If, for a taxable year of a CFC, the CFC holds one or more items of specified property that correspond to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, then the extraordinary disposition account is reduced (but not below zero) by the lesser of the amounts described in paragraphs (c)(1)(i) and (ii) of this section (each determined in the functional currency of the CFC).

(i) The excess (if any) of the adjusted earnings of the CFC for the taxable year of the CFC, over the sum of the previously taxed earnings and profits accounts with respect to the CFC for purposes of section 959 (determined as of the end of the tax-

able year of the CFC and taking into account any adjustments to the accounts for the taxable year).

(ii) The balance of the section 245A shareholder's RGI account with respect to the CFC (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(ii) of this section for the taxable year).

(2) *Timing of reduction to extraordinary disposition account.* See §1.245A-9(b)(3) for timing rules regarding the reduction to an extraordinary disposition account.

(3) *Adjusted earnings.* The term *adjusted earnings* means, with respect to a CFC and a taxable year of the CFC, the earnings and profits of the CFC, determined as of the end of the CFC's taxable year (taking into account all distributions during the taxable year), and with the adjustments described in paragraphs (c)(3)(i) through (iii) of this section.

(i) The earnings and profits are increased by the amount of any deduction or loss that is or was allocated and apportioned to residual CFC gross income of the CFC solely by reason of §1.951A-2(c)(5)(i).

(ii) The earnings and profits are decreased by the amount by which an RGI account with respect to the CFC has been decreased pursuant to paragraph (c)(4)(ii) of this section for a prior taxable year of the CFC.

(iii) The earnings and profits are determined without regard to income described in section 245(a)(5)(A) or dividends described in section 245(a)(5)(B) (determined without regard to section 245(a)(12)).

(4) *RGI account.* For a taxable year of a CFC, the following rules apply to determine the balance of a section 245A shareholder's RGI account with respect to the CFC:

(i) The balance of the RGI account is increased by the sum of the amounts of deductions and losses of the CFC that, but for §1.951A-2(c)(5)(i), would have decreased one or more categories of the CFC's positive subpart F income or the CFC's tested income, or increased or given rise to a tested loss or one or more qualified deficits of the CFC.

(ii) The balance of the RGI account is decreased to the extent that, by reason of the application of paragraph (c)(1) of this

section with respect to the taxable year of the CFC, there is a reduction to the extraordinary disposition account of the section 245A shareholder.

§1.245A-8 Coordination rules for complex cases.

(a) *Scope.* This section applies beginning with the first day of the first taxable year of a section 245A shareholder for which §1.245A-7 does not apply and for all taxable years thereafter, or for a taxable year of a section 245A shareholder for which the section 245A shareholder chooses not to apply §1.245A-7.

(b) *Reduction of disqualified basis by reason of an extraordinary disposition amount or tiered extraordinary disposition amount—(1) In general.* If, for a taxable year of a section 245A shareholder, an extraordinary disposition account of the section 245A shareholder gives rise to one or more extraordinary disposition amounts or tiered extraordinary disposition amounts, then, with respect to an item of specified property that corresponds to the extraordinary disposition account and for which the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder, solely for purposes of §1.951A-2(c)(5), the disqualified basis of the item of specified property is reduced (but not below zero) by an amount (determined in the functional currency in which the extraordinary disposition account is maintained) equal to the product of—

(i) The excess (if any) of—

(A) The sum of the extraordinary disposition amounts and the tiered extraordinary disposition amounts; over

(B) The basis benefit account with respect to the extraordinary disposition account (determined as of the end of the taxable year of the section 245A shareholder, and without regard to the application of paragraph (b)(4)(i)(B) of this section for the taxable year); and

(ii) A fraction, the numerator of which is the disqualified basis of the item of specified property, and the denominator of which is the sum of the disqualified basis of each item of specified property that corresponds to the extraordinary disposition account and for which the ownership requirement of paragraph (b)(3)(i) of this

section is satisfied for the taxable year of the section 245A shareholder.

(2) *Timing rules regarding disqualified basis.* See §1.245A-9(b)(2) for timing rules regarding the determination of, and reduction to, disqualified basis of an item of specified property.

(3) *Ownership requirement with respect to an item of specified property—(i) In general.* For a taxable year of a section 245A shareholder, the ownership requirement of this paragraph (b)(3)(i) is satisfied with respect to an item of specified property if, on at least one day that falls within the taxable year, the item of specified property is held by—

(A) The section 245A shareholder;

(B) A person (other than the section 245A shareholder) that, on at least one day that falls within the section 245A shareholder's taxable year, is a related party with respect to the section 245A shareholder (such a person, a *qualified related party* with respect to the section 245A shareholder for the taxable year of the section 245A shareholder); or

(C) A specified entity at least 10 percent of the interests of which are, on at least one day that falls within the section 245A shareholder's taxable year, owned directly or indirectly through one or more other specified entities by the section 245A shareholder or a qualified related party.

(ii) *Rules for determining an interest in a specified entity.* For purposes of paragraph (b)(3)(i)(C) of this section, the phrase *at least 10 percent of the interests* means—

(A) If the specified entity is a foreign corporation, at least 10 percent of the stock (by vote or value) of the foreign corporation;

(B) If the specified entity is a partnership, at least 10 percent of the interests in the capital or profits of the partnership; or

(C) If the specified entity is not a foreign corporation or a partnership, at least 10 percent of the value of the interests in the specified entity.

(4) *Basis benefit account—(i) General rules.* The term *basis benefit account* means, with respect to an extraordinary disposition account of a section 245A shareholder, an account of the section 245A shareholder (the initial balance of which is zero), adjusted pursuant to the rules of paragraphs (b)(4)(i)(A) and (B) of

this section on the last day of each taxable year of the section 245A shareholder. The basis benefit account must be maintained in the same functional currency as the extraordinary disposition account.

(A) The balance of the basis benefit account is increased to the extent that a basis benefit amount with respect to an item of specified property that corresponds to the section 245A shareholder's extraordinary disposition account is assigned to the taxable year of the section 245A shareholder. However, if the extraordinary disposition ownership percentage applicable to the section 245A shareholder's extraordinary disposition account is less than 100 percent, then, the basis benefit account is instead increased by the amount equal to the basis benefit amount multiplied by the extraordinary disposition ownership percentage.

(B) The balance of the basis benefit account is decreased to the extent that, for a taxable year that includes the date on which the section 245A shareholder's taxable year ends, disqualified basis of an item of specified property would have been reduced pursuant to paragraph (b)(1) of this section but for an amount in the basis benefit account.

(ii) *Rules for determining a basis benefit amount—(A) In general.* The term *basis benefit amount* means, with respect to an item of specified property that has disqualified basis, the portion of disqualified basis that, for a taxable year, is directly (or indirectly through one or more specified entities that are not corporations) taken into account for U.S. tax purposes by a U.S. tax resident, a CFC described in §1.267A-5(a)(17), or a specified foreign person and—

(1) Reduces the amount of the U.S. tax resident's taxable income, one or more categories of the CFC's positive subpart F income, the CFC's tested income, or the specified foreign person's ECTI, as applicable; or

(2) Prevents a decrease or offset of the amount of the CFC's tested loss or qualified deficits.

(B) *Rules for determining whether disqualified basis of an item of specified property is taken into account.* For purposes of paragraph (b)(4)(ii)(A) of this section, disqualified basis of an item of specified property is taken into account for U.S. tax

purposes without regard to whether the disqualified basis is reduced or eliminated under §1.951A-3(h)(2)(ii)(B)(I).

(C) *Timing rules when disqualified basis gives rise to a deferred or disallowed loss.* To the extent disqualified basis of an item of specified property gives rise to a deduction or loss during a taxable year that is deferred, then the determination of whether the item of deduction or loss gives rise to a basis benefit amount under paragraph (b)(4)(ii)(A) of this section is made when the item of deduction or loss is no longer deferred. In addition, to the extent disqualified basis of an item of specified property gives rise to a deduction or loss during a taxable year that is disallowed under section 267(a)(1), then a basis benefit amount is treated as occurring in the taxable year when and to the extent that gain is reduced pursuant to section 267(d), and provided that the gain is described in paragraph (b)(4)(ii)(A) of this section.

(iii) *Rules for assigning a basis benefit amount to a taxable year of a section 245A shareholder*—(A) *In general.* For purposes of applying paragraph (b)(4)(i)(A) of this section with respect to a section 245A shareholder, a basis benefit amount with respect to an item of specified property is assigned to a taxable year of the section 245A shareholder if—

(1) With respect to the item of specified property, the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder; and

(2) The basis benefit amount occurs during the taxable year of the section 245A shareholder, or a taxable year of a U.S. tax resident (other than the section 245A shareholder), a CFC described in §1.267A-5(a)(17), or a specified foreign person, as applicable, that—

(i) Ends with or within the taxable year of the section 245A shareholder; or

(ii) Begins with or within the taxable year of the section 245A shareholder, but only in a case in which but for this paragraph (b)(4)(iii)(A)(2)(ii) the basis benefit amount would not be assigned to a taxable year of the section 245A shareholder.

(B) *Anti-duplication rule.* For purposes of paragraph (b)(4)(i)(A) of this section, to the extent that disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a

taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter such disqualified basis gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder. Thus, for example, if the entire amount of disqualified basis of an item of specified property gives rise to a basis benefit amount for a particular taxable year of a CFC and is assigned to a taxable year of a section 245A shareholder but, pursuant to §1.951A-3(h)(2)(ii)(B)(I)(ii), the disqualified basis is not reduced or eliminated in such taxable year of the CFC (because, for example, the buyer is a CFC that is a related party) and, as a result, the disqualified basis thereafter gives rise to an additional basis benefit amount, then no portion of the additional basis benefit amount is assigned to a taxable year of any section 245A shareholder.

(iv) *Successor rules for basis benefit accounts.* To the extent that an extraordinary disposition account of a section 245A shareholder is adjusted pursuant to §1.245A-5(c)(4), a basis benefit account with respect to the extraordinary disposition account is adjusted in a similar manner.

(5) *Special rules regarding duplicate DQB of an item of exchanged basis property*—(i) *Adjustments to certain rules in applying paragraph (b)(1) of this section.* For purposes of paragraph (b)(1) of this section for a taxable year of a section 245A shareholder, the following rules apply with respect to duplicate DQB of an item of exchanged basis property:

(A) Duplicate DQB of the item of exchanged basis property with respect to an item of specified property to which the item of exchanged property relates is not taken into account for purposes of paragraph (b)(1) of this section if the disqualified basis of the item of specified property is taken into account for purposes of paragraph (b)(1) of this section. Thus, for example, if for a taxable year of a section 245A shareholder the ownership requirement of paragraph (b)(3) of this section is satisfied with respect to an item of specified property and an item of exchanged basis property that relates to the item of specified property, all of the disqualified basis of which is duplicate DQB with

respect to the item of specified property, then only the disqualified basis of the item of specified property is taken into account for purposes of, and is subject to reduction under, paragraph (b)(1) of this section.

(B) If, pursuant to paragraph (b)(5)(i)(A) of this section, duplicate DQB of an item of exchanged basis property with respect to an item of specified property is not taken into account for purposes of paragraph (b)(1) of this section, then, solely for purposes of §1.951A-2(c)(5), the duplicate DQB of the item of exchanged basis property is reduced (in the same manner as it would be if the disqualified basis were taken into account for purposes of paragraph (b)(1) of this section) by the product of the amounts described in paragraphs (b)(5)(i)(B)(I) and (2) of this section.

(1) The reduction, under paragraph (b)(1) of this section for the taxable year of the section 245A shareholder, to the disqualified basis of the item of specified property to which the item of exchanged basis property relates.

(2) A fraction, the numerator of which is the duplicate DQB of the item of exchanged basis property with respect to the item of specified property, and the denominator of which is the sum of the amounts of duplicate DQB with respect to the item of specified property of each item of exchanged basis property that relates to the item of specified property and for which the ownership requirement of paragraph (b)(3)(i) of this section is satisfied for the taxable year of the section 245A shareholder. For purposes of determining this fraction, duplicate DQB of an item of exchanged basis property is determined pursuant to the rules of paragraph (b)(2)(i) of this section (by replacing the term “paragraph (b)(1)” in that paragraph with the term “paragraph (b)(5)(i)(B)”). In addition, duplicate DQB of an item of exchanged basis property is excluded from the denominator of the fraction to the extent the duplicate DQB is attributable to duplicate DQB of another item of exchanged basis property that is included in the denominator of the fraction.

(ii) *Adjustments to certain rules in applying paragraph (b)(4) of this section.* For purposes of paragraph (b)(4)(i)(A) of this section, to the extent that disqualified basis of an item of specified property gives

rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter duplicate DQB attributable to such disqualified basis of the item of specified property gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder. Similarly, for purposes of paragraph (b)(4)(i)(A) of this section, to the extent that duplicate DQB attributable to disqualified basis of an item of specified property gives rise to a basis benefit amount that is assigned to a taxable year of a section 245A shareholder under paragraph (b)(4)(iii)(A) of this section, and thereafter such disqualified basis of the item of specified property (or duplicate DQB attributable to such disqualified basis of the item of specified property) gives rise to an additional basis benefit amount, the additional basis benefit amount cannot be assigned to another taxable year of any section 245A shareholder.

(6) *Special rule regarding prior extraordinary disposition amounts.* For purposes of paragraph (b)(1) of this section, to the extent that an extraordinary disposition account of a section 245A shareholder is reduced under §1.245A-5(c)(3)(i)(A) by reason of a prior extraordinary disposition amount described in §1.245A-5(c)(3)(i)(D)(I)(i) through (iv), the extraordinary disposition account is considered to give rise to an extraordinary disposition amount or tiered extraordinary disposition amount (and the amount by which the account is reduced is treated as an extraordinary disposition amount or tiered extraordinary disposition amount).

(c) *Reduction of extraordinary disposition account by reason of the allocation and apportionment of deductions or losses attributable to disqualified basis—(1) In general.* For a taxable year of a CFC, if there is an RGI account with respect to the CFC that relates to an extraordinary disposition account of a section 245A shareholder with respect to an SFC, and the section 245A shareholder satisfies the ownership requirement of paragraph (c)(5) of this section for the taxable year of the CFC, then, subject to the limitations in paragraphs (c)(6) and (7) of this section, the extraordinary disposition account is reduced (but not below zero) by the less-

er of the following amounts (each determined in the functional currency of the CFC)—

(i) The excess (if any) of—

(A) The product of—

(1) The adjusted earnings of the CFC for the taxable year of the CFC; and

(2) The percentage of stock of the CFC (by value) that, in aggregate, is owned directly or indirectly through one or more specified entities by the section 245A shareholder and any domestic affiliates on the last day of the taxable year of the CFC; over

(B) The sum of—

(1) The sum of the balance of the section 245A shareholder's and any domestic affiliates' previously taxed earnings and profits accounts with respect to the CFC for purposes of section 959 (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year);

(2) The sum of the balance of the hybrid deduction accounts (as described in §1.245A(e)-1(d)(1)) with respect to shares of stock of the CFC that the section 245A shareholder and any domestic affiliates own (within the meaning of section 958(a), and determined by treating a domestic partnership as foreign) as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year; and

(3) The sum of the balance of the section 245A shareholder's and any domestic affiliates' extraordinary disposition accounts with respect to the CFC (determined as of the end of the taxable year of the CFC and taking into account any adjustments to the accounts for the taxable year). However, if the section 245A shareholder or a domestic affiliate has an RGI account with respect to the CFC that relates to an extraordinary disposition account with respect to the CFC, then only the excess, if any, of the balance of the extraordinary disposition account over the balance of the RGI account that relates to the extraordinary disposition account (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(i)(B) of this section for the taxable year) is taken into account for purposes of this paragraph (c)(1)(i)(B)(3). In addition, for purposes of this paragraph (c)(1)(i)(B)(3), an ex-

traordinary disposition account that but for paragraph (e)(1) of this section would be with respect to the CFC for purposes of this section is treated as an extraordinary disposition account with respect to the CFC and thus is taken into account for purposes of this paragraph (c)(1)(i)(B)(3).

(ii) The balance of the RGI account with respect to the CFC that relates to the section 245A shareholder's extraordinary disposition account with respect to the SFC (determined as of the end of the taxable year of the CFC, but without regard to the application of paragraph (c)(4)(i)(B) of this section for the taxable year).

(2) *Timing of reduction to extraordinary disposition account.* See §1.245A-9(b)(3) for timing rules regarding the reduction to an extraordinary disposition account.

(3) *Adjusted earnings.* The term *adjusted earnings* means, with respect to a CFC and a taxable year of the CFC, the earnings and profits of the CFC, determined as of the end of the CFC's taxable year (taking into account all distributions during the taxable year, and not taking into account any deficit in earnings and profits subject to §1.381(c)(2)-1(a)(5)) and with the adjustments described in paragraphs (c)(3)(i) through (iv) of this section.

(i) The earnings and profits are increased by the amount of any deduction or loss that—

(A) Is or was attributable to disqualified basis of an item of specified property, but only to the extent that gain recognized on the extraordinary disposition of the item of specified property was included in the initial balance of an extraordinary disposition account;

(B) Is or was allocated and apportioned to residual CFC gross income of the CFC (or a predecessor) solely by reason of §1.951A-2(c)(5)(i); and

(C) Does not or has not given rise to or increased a deficit in earnings and profits subject to §1.381(c)(2)-1(a)(5), determined as of the end of the taxable year of the CFC.

(ii) The earnings and profits are decreased by the amount by which any RGI account with respect to the CFC has been decreased pursuant to paragraph (c)(4)(i)(B) of this section for a prior taxable year of the CFC.

(iii) The earnings and profits are determined without regard to earnings attribut-

able to income described in section 245(a)(5)(A) or dividends described in section 245(a)(5)(B) (determined without regard to section 245(a)(12)).

(iv) The earnings and profits are decreased by the amount of any deduction or loss that, but for paragraph (c)(3)(i)(C) of this section, would be described in paragraph (c)(3)(i) of this section.

(4) *RGI account*—(i) *In general.* For a taxable year of a CFC, the following rules apply to determine the balance of a section 245A shareholder's RGI account that is with respect to the CFC and that relates to an extraordinary disposition account of the section 245A shareholder with respect to an SFC:

(A) The balance of the RGI account is increased by the product of the amounts described in paragraphs (c)(4)(i)(A)(1) and (2) of this section for a taxable year of the CFC.

(1) The sum of the amounts of deductions and losses of the CFC that—

(i) Are attributable to disqualified basis of one or more items of specified property that correspond to the extraordinary disposition account; and

(ii) But for §1.951A-2(c)(5)(i), would have decreased one or more categories of the CFC's positive subpart F income, the CFC's tested income, or the CFC's ECTI, or increased or given rise to a tested loss or one or more qualified deficits of the CFC.

(2) The lesser of—

(i) A fraction (expressed as a percentage), the numerator of which is the sum of the portions of the CFC's subpart F income and tested income or tested loss (expressed as a positive number) taken into account under sections 951(a)(1)(A) and 951A(a) (as determined under the rules of §§1.951-1(b) and (e) and 1.951A-1(d)) by the section 245A shareholder and any domestic affiliates of the section 245A shareholder and the section 245A shareholder's and any domestic affiliates' pro rata shares of the CFC's qualified deficits (expressed as a positive number), and the denominator of which is the sum of the CFC's subpart F income, tested income or tested loss (expressed as a positive number), and qualified deficits (expressed as a positive number), but for purposes of this paragraph (c)(4)(i)(A)(2)(i) treating ECTI (expressed as a

positive number) as if it were subpart F income; and

(ii) The extraordinary disposition ownership percentage applicable as to the section 245A shareholder's extraordinary disposition account.

(B) The balance of the RGI account is decreased to the extent that, by reason of the application of paragraph (c)(1) of this section with respect to the taxable year of the CFC, there is a reduction to the extraordinary disposition account of the section 245A shareholder.

(ii) *Successor rules for RGI accounts.* To the extent that an extraordinary disposition account of a section 245A shareholder is adjusted pursuant to §1.245A-5(c)(4), an RGI account of a CFC with respect to the extraordinary disposition account is adjusted in a similar manner.

(5) *Ownership requirement with respect to a CFC.* For a taxable year of a CFC, a section 245A shareholder satisfies the ownership requirement of this paragraph (c)(5) if, on the last day of the CFC's taxable year, the section 245A shareholder or a domestic affiliate is a United States shareholder with respect to the CFC.

(6) *Allocation of reductions among multiple extraordinary disposition accounts.* This paragraph (c)(6) applies if, by reason of the application of paragraph (c)(1) of this section with respect to a taxable year of a CFC (and but for the application of this paragraph (c)(6) and paragraph (c)(7) of this section), the sum of the reductions under paragraph (c)(1) of this section to two or more extraordinary disposition accounts of a section 245A shareholder or a domestic affiliate of the section 245A shareholder would exceed the amount described in paragraph (c)(1)(i)(A) of this section (the amount of such excess, the *excess amount*). When this paragraph (c)(6) applies, the reduction to each extraordinary disposition account described in the previous sentence is equal to the reduction that would occur but for this paragraph (c)(6) and paragraph (c)(7) of this section, less the product of the excess amount and a fraction, the numerator of which is the balance of the extraordinary disposition account, and the denominator of which is the sum of the balances of all of the extraordinary dispositions accounts described in the previous sentence. For purposes of determining this fraction,

the balance of an extraordinary disposition account is determined as of the end of the taxable year of the section 245A shareholder or the domestic affiliate, as applicable, that includes the date on which the CFC's taxable year ends (and after the determination of any extraordinary disposition amounts or tiered extraordinary disposition amounts for the taxable year of the section 245A shareholder or the domestic affiliate, as applicable, and adjustments to the extraordinary disposition account for prior extraordinary disposition amounts).

(7) *Extraordinary disposition account not reduced below balance of basis benefit account.* An extraordinary disposition account of a section 245A shareholder cannot be reduced pursuant to paragraph (c)(1) of this section below the balance of the basis benefit account with respect to the extraordinary disposition account (determined when a reduction to the extraordinary disposition account would occur under paragraph (c)(1) of this section).

(d) *Special rules for determining when specified property corresponds to an extraordinary disposition account*—(1) *Substituted property*—(i) *Treatment as specified property that corresponds to an extraordinary disposition account.* For purposes of this section, an item of substituted property is treated as an item of specified property that corresponds to an extraordinary disposition account to which the related item of specified property (that is, the item of specified property to which the item of substituted property relates, as described in paragraph (d)(1)(ii) of this section) corresponds. In addition, in a case in which an item of substituted property relates to an item of specified property that corresponds to a particular extraordinary disposition account and an item of specified property that corresponds to another extraordinary disposition account (such that, pursuant to this paragraph (d)(1)(i), the item of substituted property is treated as corresponding to multiple extraordinary disposition accounts), only the disqualified basis of the item of substituted property attributable to the first item of specified property is taken into account for purposes of applying this section as to the first extraordinary disposition account, and, similarly, only the disqualified basis of the item of substituted property

attributable to the second item of specified property is taken into account for purposes of applying this section as to the second extraordinary disposition account.

(ii) *Definition of substituted property.* The term *substituted property* means an item of property the disqualified basis of which is, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(i) or (iii), increased by reason of a reduction under §1.951A-3(h)(2)(ii)(B)(1) in disqualified basis of an item of specified property. An item of substituted property relates to an item of specified property if the disqualified basis of the item of substituted property was increased by reason of a reduction in disqualified basis of the item of specified property.

(2) *Exchanged basis property*—(i) *Treatment as specified property that corresponds to an extraordinary disposition account for certain purposes.* For purposes of this section, an item of exchanged basis property is treated as an item of specified property that corresponds to an extraordinary disposition account to which the related item of specified property (that is, the item of specified property to which the item of exchanged basis property relates) corresponds.

(ii) *Definition of exchanged basis property.* The term *exchanged basis property* means an item of property the disqualified basis of which, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(ii), includes disqualified basis of an item of specified property. An item of exchanged basis property relates to an item of specified property if the disqualified basis of the item of exchanged basis property includes disqualified basis of the item of specified property.

(iii) *Definition of duplicate DQB*—(A) *In general.* The term *duplicate DQB* means, with respect to an item of exchanged basis property and the item of specified property to which the exchanged basis property relates, the disqualified basis of the item of exchanged basis property that includes or is attributable to disqualified basis of the item of specified property.

(B) *Certain nonrecognition transfers involving stock or a partnership interest.* To the extent that an item of exchanged basis property that is stock or an interest in a partnership (*lower-tier item*) includes disqualified basis of an item of specified property to which the lower-tier item relates (*contributed item*), and another item

of exchanged basis property that is stock or a partnership interest (*upper-tier item*) includes disqualified basis of the lower-tier item that is attributable to disqualified basis of the contributed item, the disqualified basis of the upper-tier item is attributable to disqualified basis of the contributed item and the upper-tier item is an item of exchanged basis property that relates to the contributed item. The principles of the preceding sentence apply each time disqualified basis of an item of exchanged basis property that is stock or an interest in a partnership is included in disqualified basis of another item of exchanged basis property that is stock or an interest in a partnership.

(C) *Multiple nonrecognition transfers of an item of specified property.* To the extent that multiple items of exchanged basis property that are stock or interests in a partnership include disqualified basis of the same item of specified property (*contributed item*) to which the items of exchanged basis property relate, and the issuer of one of the items of exchanged basis property (*upper-tier successor item*) receives the other item of exchanged basis property (*lower-tier successor item*) in exchange for the contributed property, the disqualified basis of the upper-tier successor item is attributable to disqualified basis of the lower-tier successor item and the upper-tier successor item is an item of exchanged basis property that relates to the lower-tier successor item. The principles of the preceding sentence apply each time disqualified basis of an item of specified property to which an item of exchanged basis property that is stock or an interest in partnership relates is included in disqualified basis of another item of exchanged basis property that is stock or an interest in a partnership.

(e) *Special rules when extraordinary disposition accounts are adjusted pursuant to §1.245A-5(c)(4)*—(1) *Extraordinary disposition account with respect to multiple SFCs.* This paragraph (e)(1) applies if, pursuant to §1.245A-5(c)(4)(ii) or (iii) (the transaction or transactions by reason of which §1.245A-5(c)(4)(ii) or (iii) applies, the *adjustment transaction*), an extraordinary disposition account of a section 245A shareholder with respect to an SFC (such extraordinary disposition account, the *transferor ED account*; and

such SFC, the *transferor SFC*) gives rise to an increase in the balance of an extraordinary disposition account with respect to another SFC (such extraordinary disposition account, the *transferee ED account*; such SFC, the *transferee SFC*; and such increase, the *adjustment amount*). When this paragraph (e)(1) applies, the following rules apply for purposes of this section:

(i) A ratable portion of the transferee ED account is treated as retaining its status as an extraordinary disposition account with respect to the transferor SFC and is not treated as an extraordinary disposition account with respect to the transferee SFC (the transferee ED account to such extent, the *deemed transferor ED account*), based on the adjustment amount relative to the balance of the transferee ED account (without regard to this paragraph (e)(1)) immediately after the adjustment transaction. Thus, for example, whether or not the transferor SFC is in existence immediately after the transaction, the items of specified property that correspond to the deemed transferor ED account are the same as the items of specified property that correspond to the transferor ED account. As an additional example, whether or not the transferor SFC is in existence immediately after the transaction the extraordinary disposition ownership percentage with respect to the deemed transferor ED account is the same as the extraordinary disposition ownership percentage with respect to the transferor ED account (except to the extent the extraordinary disposition ownership percentage is adjusted pursuant to the rules of paragraph (e)(2) of this section).

(ii) In the case of an amount (such as an extraordinary disposition amount or tiered extraordinary disposition amount) determined by reference to the transferee ED account (without regard to this paragraph (e)(1)), the portion of the amount that is considered attributable to the deemed transferor ED account (and not the transferee ED account) is equal to the product of such amount and a fraction, the numerator of which is the balance of the deemed transferor ED account, and the denominator of which is the balance of the transferee ED account (determined without regard to this paragraph (e)(1)). Thus, for example, if after an adjustment transaction

the transferee ED account (without regard to this paragraph (e)(1)) gives rise to an extraordinary disposition amount, and if the fraction (expressed as a percentage) is 40, then, for purposes of this section, 40 percent of the extraordinary disposition amount is treated as attributable to the deemed transferor ED account and the remaining 60 percent of the extraordinary disposition amount is attributable to the transferee ED account, and the balance of each of the deemed transferor ED account and the transferee ED account is correspondingly reduced.

(2) *Extraordinary disposition accounts with respect to a single SFC.* If an extraordinary disposition account of a section 245A shareholder with respect to an SFC is reduced by reason of §1.245A-5(c)(4), then, except as provided in paragraph (e)(1) of this section, for purposes of this section, the extraordinary disposition ownership percentage as to the extraordinary disposition account (as well as the extraordinary disposition ownership percentage as to any extraordinary disposition account with respect to the SFC that is increased by reason of the reduction) is adjusted in a similar manner.

§1.245A-9 Other rules and definitions.

(a) *In general.* This section provides rules of general applicability for purposes of §§1.245A-6 through 1.245A-10, a transition rule to revoke an election to eliminate disqualified basis, and definitions.

(b) *Rules of general applicability—*
(1) *Correspondence.* An item of specified property corresponds to a section 245A shareholder's extraordinary disposition account if gain was recognized on the extraordinary disposition of the item and the gain was taken into account in determining the initial balance of the account. See §1.245A-8(d) for additional rules regarding when an item of property is treated as corresponding to an extraordinary disposition account in certain complex cases.

(2) *Timing rules related to disqualified basis for purposes of applying §§1.245A-7(b) and 1.245A-8(b)—*(i) *Determination of disqualified basis.* For purposes of determining the fraction described in §1.245A-7(b)(1)(ii) or §1.245A-8(b)(1)(ii) when applying

§1.245A-7(b)(1) or §1.245A-8(b)(1)(ii), respectively, for a taxable year of a section 245A shareholder, disqualified basis of an item of specified property is determined as of the beginning of the taxable year of the CFC that holds the item of specified property (in a case in which §1.245A-7(b) applies) or the specified property owner (in a case in which §1.245A-8(b) applies), in either case, that includes the date on which the section 245A shareholder's taxable year ends (and without regard to any reductions to the disqualified basis of the item of specified property pursuant to §1.245A-7(b)(1) or §1.245A-8(b)(1) for such taxable year of the CFC or the specified property owner, as applicable). However, if disqualified basis of the item of specified property arose as a result of an extraordinary disposition that occurred after the beginning of the taxable year of the CFC or the specified property owner described in the preceding sentence, then the disqualified basis of the item of specified property is determined as of the date on which the extraordinary disposition occurred (and without regard to any reductions to the disqualified basis of the item of specified property pursuant to paragraph (b)(1) of this section for such taxable year of the CFC or the specified property owner).

(ii) *Reduction to disqualified basis of an item of specified property.* The reduction to disqualified basis of an item of specified property pursuant to §1.245A-7(b)(1) or §1.245A-8(b)(1) occurs on the date described in paragraph (b)(2)(i) of this section.

(iii) *Definition of specified property owner.* For purposes of applying §1.245A-8(b)(1) and paragraphs (b)(2)(i) and (ii) of this section for a taxable year of a section 245A shareholder, the term *specified property owner* means, with respect to an item of specified property, the person that, on at least one day of the taxable year of the person that includes the date on which the section 245A shareholder's taxable year ends, held the item of specified property. However, if, but for this sentence, there would be more than one specified property owner with respect to the item of specified property, then the specified property owner is the person that held the item of specified property on the

earliest date that falls within the section 245A shareholder's taxable year.

(3) *Timing rules for reducing an extraordinary disposition account under §§1.245A-7(c) and 1.245A-8(c).* For purposes of §1.245A-7(c)(1) or §1.245A-8(c)(1), as applicable, with respect to a taxable year of a CFC, the reduction to an extraordinary disposition account pursuant to §1.245A-7(c)(1) or §1.245A-8(c)(1) occurs as of the end of the taxable year of the section 245A shareholder that includes the date on which the CFC's taxable year ends (and after the determination of any extraordinary disposition amounts or tiered extraordinary amounts, adjustments to the extraordinary disposition account for prior extraordinary disposition amounts, and the application of §1.245A-7(b) or §1.245A-8(b), as applicable, each for the taxable year of the section 245A shareholder).

(4) *Currency translation.* For purposes of applying §§1.245A-7(b) and 1.245A-8(b), the disqualified basis of (and, if applicable, a basis benefit amount with respect to) an item of specified property that corresponds to an extraordinary disposition account are translated (if necessary) into the functional currency in which the extraordinary disposition account is maintained, using the spot rate on the date the extraordinary disposition occurred. A reduction in disqualified basis of an item of specified property determined under §1.245A-7(b)(1) or §1.245A-8(b)(1) is translated (if necessary) into the functional currency in which the disqualified basis of the item of specified property is maintained, and a reduction in an extraordinary disposition account determined under §1.245A-7(c) or §1.245A-8(c) section is translated (if necessary) into the functional currency in which the extraordinary disposition account is maintained, in each case using the spot rate described in the preceding sentence.

(5) *Anti-avoidance rule.* Appropriate adjustments are made pursuant to this paragraph (b)(5), including adjustments that would disregard a transaction or arrangement in whole or in part, to any amounts determined under (or subject to application of) this section if a transaction or arrangement is engaged in with a principal purpose of avoiding the purposes of §§1.245A-6 through 1.245A-10.

(c) *Transition rule to revoke election to eliminate disqualified basis*—(1) *In general.* This paragraph (c)(1) applies to an election that is filed, pursuant to §1.951A-3(h)(2)(ii)(B)(3), to eliminate the disqualified basis of an item of specified property. An election to which this paragraph (c)(1) applies may be revoked if, on or before March 1, 2021—

(i) All controlling domestic shareholders (as defined in §1.964-1(c)(5)) of the CFC (or, in the case of an election made by a partnership, the partnership) each attach a revocation statement (in the manner described in paragraph (c)(2) of this section) to an amended return, for the taxable year to which the election applies, that revokes the election (or, in the case of a partnership subject to subchapter C of chapter 63 of the Internal Revenue Code, requests administrative adjustment under section 6227); and

(ii) The controlling domestic shareholders (or the partnership) each file an amended tax return, for any other taxable years reflecting the election to eliminate the disqualified basis, that reflects the election having been revoked (or, in the case of a partnership subject to subchapter C of chapter 63, requests administrative adjustment under section 6227).

(2) *Revocation statement.* Except as otherwise provided in publications, forms, instructions, or other guidance, a revocation statement attached by a person to an amended tax return must include the person's name, taxpayer identification number, and a statement that the revocation statement is filed pursuant to paragraph (c)(1) of this section to revoke an election pursuant to §1.951A-3(h)(2)(ii)(B)(3). In addition, the revocation statement must be filed in the manner prescribed in publications, forms, instructions, or other guidance.

(d) *Definitions.* In addition to the definitions in §1.245A-5, the following definitions apply for purposes of §§1.245A-6 through 1.245A-11.

(1) The term *adjusted earnings* has the meaning provided in §1.245A-7(c)(3) or §1.245A-8(c)(3), as applicable.

(2) The term *basis benefit account* has the meaning provided in §1.245A-8(b)(4)(i).

(3) The term *basis benefit amount* has the meaning provided in §1.245A-8(b)(4)(ii).

(4) The term *disqualified basis* has the meaning provided in §1.951A-3(h)(2)(ii).

(5) The term *domestic affiliate* means, with respect to a section 245A shareholder, a domestic corporation that is a related party with respect to the section 245A shareholder. *See also* §1.245A-5(i)(19) (defining related party).

(6) The term *duplicate DQB* has the meaning provided in §1.245A-8(d)(2)(iii).

(7) The term *ECTI* means, with respect to a taxable year of a specified foreign person, the taxable income (or loss) of the specified foreign person determined by taking into account only items of income and gain that are, or are treated as, effectively connected with the conduct of a trade or business in the United States (as described in §1.882-4(a)(1)) and are not exempt from U.S. tax pursuant to a treaty obligation of the United States, and items of deduction and loss that are allocated and apportioned to such items of income and gain.

(8) The term *exchanged basis property* has the meaning provided in §1.245A-8(d)(2)(ii).

(9) The term *qualified deficit* has the meaning provided in section 952(c)(1)(B)(ii).

(10) The term *qualified related party* has the meaning provided in §1.245A-8(b)(3)(ii).

(11) The term *RGI account* means, with respect to a CFC and an extraordinary disposition account of a section 245A shareholder with respect to an SFC, an account of the section 245A shareholder with respect to an SFC (the initial balance of which is zero), adjusted at the end of each taxable year of the CFC pursuant to the rules of §1.245A-7(c)(4) or §1.245A-8(c)(4), as applicable. The RGI account must be maintained in the functional currency of the CFC.

(12) The term *specified foreign person* means a nonresident alien individual (as defined in section 7701(b) and the regulations under section 7701(b)) or a foreign corporation (including a CFC) that conducts, or is treated as conducting, a trade or business in the United States (as described in §1.882-4(a)(1)).

(13) The term *specified property owner* has the meaning provided in §1.245A-8(b)(2)(iii).

(14) The term *subpart F income* has the meaning provided in section 952(a).

(15) The term *substituted property* has the meaning provided in §1.245A-8(d)(1)(ii).

(16) The term *tested income* has the meaning provided in section 951A(c)(2)(A).

(17) The term *tested loss* has the meaning provided in section 951A(c)(2)(B).

§1.245A-10 Examples.

(a) *Scope.* This section provides examples illustrating the application of §§1.245A-6 through 1.245A-9.

(b) *Presumed facts.* For purposes of the examples in the section, except as otherwise stated, the following facts are presumed:

(1) US1 and US2 are both domestic corporations that have calendar taxable years.

(2) CFC1, CFC2, CFC3, and CFC4 are all SFCs and CFCs that have taxable years ending November 30.

(3) Each entity uses the U.S. dollar as its functional currency.

(4) There are no items of deduction or loss attributable to an item of specified property.

(5) Absent the application of §1.245A-5, any dividends received by US1 from CFC1 would meet the requirements to qualify for the section 245A deduction.

(6) All dispositions of items of specified property by an SFC during a disqualified period of the SFC to a related party give rise to an extraordinary disposition.

(7) None of the CFCs have a deficit subject to §1.381(c)(2)-1(a)(5), and none of the CFCs are engaged in the conduct of a trade or business in the United States (and therefore none of the CFCs have ECTI).

(8) There is no previously taxed earnings and profits account with respect to any CFC for purposes of section 959. In addition, each hybrid deduction account with respect to a share of stock of a CFC has a zero balance at all times. Further, there is no extraordinary disposition account with respect to any CFC.

(9) Under §1.245A-11(b), taxpayers choose to apply §§1.245A-6 through 1.245A-11 to the relevant taxable years.

(c) *Examples*—(1) *Example 1. Reduction of disqualified basis under rule for simple cases by reason of dividend paid out of extraordinary disposition account*—(i) *Facts.* US1 owns 100% of the single class

of stock of CFC1 and CFC2. On November 30, 2018, in a transaction that is an extraordinary disposition, CFC1 sells two items of specified property, Item 1 and Item 2, to CFC2 in exchange for \$150x of cash (the “Disqualified Transfer”). Item 1 is sold for \$90x and Item 2 is sold for \$60x. Item 1 and Item 2 each has a basis of \$0 in the hands of CFC1 immediately before the Disqualified Transfer, and therefore CFC1 recognizes \$150x of gain as a result of the Disqualified Transfer (\$150x - \$0). After the Disqualified Transfer, CFC2’s only assets are Item 1 and Item 2. On November 30, 2018, and thus during US1’s taxable year ending December 31, 2018, CFC1 distributes \$150x of cash to US1, and all of the distribution is characterized as a dividend under section 301(c)(1) and treated as a distribution out of earnings and profits described in section 959(c)(3). For CFC1’s taxable year ending on November 30, 2018, CFC1 has \$160x of earnings and profits described in section 959(c)(3), without regard to any distributions during the taxable year. CFC2 continues to hold Item 1 and Item 2. Lastly, because the conditions of §1.245A-6(b)(1) and (2) are satisfied for US1’s 2018 taxable year, US1 chooses to apply §1.245A-7 (rules for simple cases) in lieu of §1.245A-8 (rules for complex cases) for that taxable year.

(ii) *Analysis*—(A) *Application of §§1.245A-5 and 1.951A-2 as a result of the Disqualified Transfer*. As a result of the Disqualified Transfer, under §1.951A-2(c)(5), Item 1 has disqualified basis of \$90x, and Item 2 has disqualified basis of \$60x. In addition, as a result of the Disqualified Transfer, under §1.245A-5(c)(3)(i)(A), US1 has an extraordinary disposition account with respect to CFC1 with an initial balance of \$150x. Under §1.245A-5(c)(2)(i), \$10x of the dividend is considered paid out of non-extraordinary disposition E&P of CFC1 with respect to US1, and \$140x of the dividend is considered paid out of US1’s extraordinary disposition account with respect to CFC1 to the extent of the balance of the extraordinary disposition account (\$150x). Thus, the dividend of \$150x is an extraordinary disposition amount, within the meaning of §1.245A-5(c)(1), to the extent of \$140x. As a result, the balance of the extraordinary disposition account is reduced to \$10x (\$150x - \$140x).

(B) *Correspondence requirement*. Under §1.245A-9(b)(1), each of Item 1 and Item 2 corresponds to US1’s extraordinary disposition account with respect to CFC1, because as a result of the Disqualified Transfer CFC1 recognized gain with respect to Item 1 and Item 2, and the gain was taken into account in determining the initial balance of US1’s extraordinary disposition account with respect to CFC1.

(C) *Reduction of disqualified basis of Item 1*. Because Item 1 corresponds to US1’s extraordinary disposition account, the disqualified basis of Item 1 is reduced pursuant to §1.245A-7(b)(1) by reason of US1’s \$140x extraordinary disposition amount for US1’s 2018 taxable year. Paragraphs (c)(2)(ii)(C)(I) through (3) of this section describe the determinations pursuant to §1.245A-7(b)(1).

(I) To determine the reduction to the disqualified basis of Item 1, the disqualified basis of Item 1, as well as the disqualified basis of Item 2, must be determined as of the date described in §1.245A-9(b)(2)(i) (and before the application of §1.245A-7(b)(1)).

See §1.245A-7(b)(1)(ii). For each of Item 1 and Item 2, that date is December 1, 2018. December 1, 2018, is the first day of the taxable year of CFC2 (the CFC that holds Item 1 and Item 2) beginning on December 1, 2018, which is the taxable year of CFC2 that includes December 31, 2018, the date on which US1’s 2018 taxable year ends. See §1.245A-9(b)(2)(i).

(2) Pursuant to §1.245A-7(b)(1), the disqualified basis of Item 1 is reduced by \$84x, computed as the product of—

(i) \$140x, the extraordinary disposition amount; and

(ii) A fraction, the numerator of which is \$90x (the disqualified basis of Item 1 on December 1, 2018, and before the application of §1.245A-7(b)(1)), and the denominator of which is \$150x (the disqualified basis of Item 1, \$90x, plus the disqualified basis of Item 2, \$60x, in each case determined on December 1, 2018, and before the application of §1.245A-7(b)(1)). See §1.245A-7(b)(1).

(3) The \$84x reduction to the disqualified basis of Item 1 occurs on December 1, 2018, the date on which the disqualified basis of Item 1 is determined for purposes of determining the reduction pursuant to §1.245A-7(b)(1). See §1.245A-9(b)(2)(ii).

(D) *Reduction of disqualified basis of Item 2*. For reasons similar to those described in paragraph (c)(2)(ii)(C) of this section, on December 1, 2018, the disqualified basis of Item 2 is reduced by \$56x, the amount equal to the product of \$140x, the extraordinary disposition amount, and a fraction, the numerator of which is \$60x (the disqualified basis of Item 2 on December 1, 2018, and before the application of §1.245A-7(b)(1)), and the denominator of which is \$150x (the disqualified basis of Item 1, \$90x, plus the disqualified basis of Item 2, \$60x, in each case determined on December 1, 2018, and before the application of §1.245A-7(b)(1)).

(2) *Example 2. Basis benefit amount and impact on reduction to disqualified basis under rule for complex cases*—(i) *Facts*. The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that, on December 1, 2018, CFC2 sells Item 1 for \$90x of cash to an individual that is not a related party with respect to US1 or CFC2 (such transaction, the “Sale,” and such individual, “Individual A”). At the time of the Sale, CFC2’s basis in Item 1 is \$90x (all of which is disqualified basis, as described in §1.951A-3(h)(2)(ii)(A)). CFC2 takes into the account the disqualified basis of Item 1 for purposes of determining the amount of gain recognized on the Sale, which is \$0 (\$90x - \$90x); but for the disqualified basis, CFC2 would have had \$90x of gain that would have been taken into account in computing its tested income. As a result of the Sale, the condition of §1.245A-6(b)(2) is not satisfied, because on at least one day of CFC2’s taxable year beginning on December 1, 2018 (which begins within US1’s 2018 taxable year) CFC2 does not hold Item 1. See §1.245A-6(b)(2)(ii)(C)(I). US1 therefore applies §1.245A-8 (rules for complex cases) for its 2018 taxable year. See §1.245A-6(b).

(ii) *Analysis*—(A) *Ownership requirement*. With respect to each of Item 1 and Item 2, the ownership requirement of §1.245A-8(b)(3)(i) is satisfied for US1’s 2018 taxable year. This is because on at least one day that falls within US1’s 2018 taxable year,

each of Item 1 and Item 2 is held by CFC2, and US1 directly owns all of the stock of CFC2 throughout such taxable year (and thus, for purposes of applying §1.245A-8(b)(3)(i), US1 owns at least 10% of the interests of CFC2 on at least one day that falls within such taxable year). See §1.245A-8(b)(3).

(B) *Basis benefit amount with respect to Item 1 as a result of the Sale*. Under §1.245A-8(b)(4)(i), US1 has a basis benefit account with respect to its extraordinary disposition account with respect to CFC1. As described in paragraphs (c)(2)(ii)(B)(I) through (3) of this section, the balance of the basis benefit account (which is initially zero) is, on December 31, 2018, increased by \$90x, the basis benefit amount with respect to Item 1 and assigned to US1’s 2018 taxable year.

(I) By reason of the Sale, for CFC2’s taxable year beginning December 1, 2018, and ending November 30, 2019, the entire \$90x of disqualified basis of Item 1 is taken into account for U.S. tax purposes by CFC2 and, as a result, reduces CFC2’s tested income or increases CFC2’s tested loss. Accordingly, for such taxable year, there is a \$90x basis benefit amount with respect to Item 1. See §1.245A-8(b)(4)(ii)(A). The result would be the same if the Sale were to a related person and thus, pursuant to §1.951A-3(h)(2)(ii)(B)(I)(ii), no portion of the \$90x of disqualified basis were eliminated or reduced by reason of the Sale. See §1.245A-8(b)(4)(ii)(B).

(2) The \$90x basis benefit amount with respect to Item 1 is assigned to US1’s 2018 taxable year. This is because the ownership requirement of §1.245A-8(b)(3)(i) is satisfied with respect to Item 1 for US1’s 2018 taxable year, and the basis benefit amount occurs in CFC2’s taxable year beginning December 1, 2018, a taxable year of CFC2 that begins within US1’s 2018 taxable year (and, but for §1.245A-8(b)(4)(iii)(A)(2)(ii), the basis benefit amount would not be assigned to a taxable year of US1, such as the taxable year of US1 beginning January 1, 2019, given that, as result of the Sale, the ownership requirement of §1.245A-8(b)(3)(i) would not be satisfied with respect to Item 1 for such taxable year). See §1.245A-8(b)(4)(iii)(A).

(3) On December 31, 2018 (the last day of US1’s 2018 taxable year), US1’s basis benefit account with respect to its extraordinary disposition account with respect to CFC1 is increased by \$90x, the \$90x basis benefit amount with respect to Item 1 and assigned to US1’s 2018 taxable year. The basis benefit account is increased by such amount because Item 1 corresponds to US1’s extraordinary disposition account with respect to CFC1, and the extraordinary disposition ownership percentage applicable to such extraordinary disposition account is 100. See §1.245A-8(b)(4)(i)(A).

(C) *Basis benefit amount limitation on reduction to disqualified basis*. By reason of US1’s \$140x extraordinary disposition amount for US1’s 2018 taxable year, the disqualified basis of Item 1 is reduced by \$30x, and the disqualified basis of Item 2 is reduced by \$20x, pursuant to §1.245A-8(b)(1). See §1.245A-8(b). Paragraphs (c)(2)(ii)(C)(I) through (4) of this section describe the determinations pursuant to §1.245A-8(b)(1).

(I) For purposes of determining the reduction to the disqualified bases of Item 1 and Item 2, the disqualified bases of the Items are determined on December 1, 2018 (and before the application of

§1.245A-8(b)(1)). See §1.245A-8(b)(1)(ii). The disqualified bases of the Items are determined on December 1, 2018, because that date is the first day of the taxable year of CFC2 beginning on December 1, 2018, which is the taxable year of CFC2 (the specified property owner of each of Item 1 and Item 2) that includes December 31, 2018, the date on which US1's 2018 taxable year ends. See §1.245A-8(b)(2)(i). For purposes of applying §§1.245A-8(b)(1) and §1.245A-9(b)(2) for US1's 2018 taxable year, CFC2 is the specified property owner of each of Item 1 and Item 2 because, on at least one day of CFC2's taxable year that includes the date on which US1's 2018 taxable year ends (that is, on at least one day of CFC2's taxable year beginning December 1, 2018), CFC2 held the Item. See §1.245A-9(b)(2)(iii). CFC2 is the specified property owner of Item 1 even though Individual A also held Item 1 during Individual A's taxable year that includes the date on which US1's 2018 taxable year ends because CFC2 held Item 1 on an earlier date than Individual A. See §1.245A-9(b)(2)(iii).

(2) Pursuant to §1.245A-8(b)(1), the disqualified basis of Item 1 is reduced by \$30x, computed as the product of—

(i) \$50x, the excess of the extraordinary disposition amount (\$140x) over the balance of the basis benefit account with respect to US1's extraordinary disposition with respect to CFC1 (\$90x); and

(ii) A fraction, the numerator of which is \$90x (the disqualified basis of Item 1 on December 1, 2018, and before the application of §1.245A-8(b)(1)), and the denominator of which is \$150x (the disqualified basis of Item 1, \$90x, plus the disqualified basis of Item 2, \$60x, in each case determined on December 1, 2018, and before the application of §1.245A-8(b)(1)). See paragraph §1.245A-8(b)(1).

(3) Pursuant to §1.245A-8(b)(1), the disqualified basis of Item 2 is reduced by \$20x, computed as the product of—

(i) \$50x, the excess of the extraordinary disposition amount (\$140x) over the balance of the basis benefit account with respect to US1's extraordinary disposition with respect to CFC1 (\$90x); and

(ii) A fraction, the numerator of which is \$60x (the disqualified basis of Item 2 on December 1, 2018, and before the application of paragraph (b)(1) of this section), and the denominator of which is \$150x (the disqualified basis of Item 1, \$90x, plus the disqualified basis of Item 2, \$60x, in each case determined on December 1, 2018, and before the application of §1.245A-8(b)(1)). See §1.245A-8(b)(1).

(4) The \$30x and \$20x reductions to the disqualified bases of Item 1 and Item 2, respectively, occur on December 1, 2018, the date on which the disqualified bases of the Items are determined for purposes of determining the reductions pursuant to §1.245A-8(b)(1). See §1.245A-9(b)(2)(ii).

(D) *Reduction of basis benefit account.* The balance of the basis benefit account with respect to US1's extraordinary disposition account with respect to CFC1 is decreased by \$90x, the amount by which, for CFC2's taxable year beginning December 1, 2018, the disqualified bases of Item 1 and Item 2 would have been reduced pursuant to §1.245A-8(b)(1) but for the \$90x balance of the basis benefit account. See §1.245A-8(b)(4)(i)(B). The reduction to the balance of the basis benefit account occurs on

December 31, 2018, and after the completion of all other computations pursuant to §1.245A-8(b). See §1.245A-8(b)(4)(i)(B).

(3) *Example 3. Reduction in balance of extraordinary disposition account under rules for simple cases by reason of allocation and apportionment of deductions to residual CFC gross income—(i) Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that CFC1 does not make a distribution to US1. In addition, during CFC2's taxable year beginning December 1, 2018, and ending November 30, 2019, the disqualified basis of Item 1 gives rise to a \$6x amortization deduction, and the disqualified basis of Item 2 gives rise to a \$4x amortization deduction, and each of the amortization deductions is allocated and apportioned to residual CFC gross income of CFC2 solely by reason of §1.951A-2(c)(5) (though, but for §1.951A-2(c)(5), would have been allocated and apportioned to gross tested income of CFC2). Further, as of the end of CFC2's taxable year ending November 30, 2019, CFC2 has \$15x of earnings and profits. Lastly, because the conditions of §1.245A-6(b)(1) and (2) are satisfied for US1's 2018 taxable year, US1 chooses to apply §1.245A-7 (rules for simple cases) in lieu of §1.245A-8 (rules for complex cases) for that taxable year.

(ii) *Analysis.* Pursuant to §1.245A-7(c)(1), US1's extraordinary disposition account with respect to CFC1 is reduced by the lesser of the amount described in §1.245A-7(c)(1)(i) with respect to US1, and the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. See §1.245A-7(c)(1). Paragraphs (c)(3)(ii)(A) through (D) of this section describe the determinations pursuant to §1.245A-8(c)(1).

(A) *Computation of adjusted earnings of CFC2, and amount described in §1.245A-7(c)(1)(i) with respect to US1.* To determine the amount described in §1.245A-7(c)(1)(i) with respect to US1, the adjusted earnings of CFC2 must be computed for CFC2's taxable year ending November 30, 2019. See §1.245A-7(c)(1)(i). Paragraphs (c)(3)(ii)(A)(I) and (2) of this section describe these determinations.

(I) The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is \$25x, computed as \$15x (CFC2's earnings and profits as of November 30, 2019, the last day of that taxable year), plus \$10x (the sum of the \$6x and \$4x amortization deductions of CFC2 for that taxable year, which is the amount of all deductions or losses of CFC2 that is or was attributable to disqualified basis of items of specified property and allocated and apportioned to residual CFC gross income of CFC2 solely by reason of §1.951A-2(c)(5)(ii)). See §1.245A-7(c)(3).

(2) For CFC2's taxable year ending November 30, 2019, the amount described in §1.245A-7(c)(1)(i) with respect to US1 is \$25x, computed as the excess of \$25x (the adjusted earnings) over \$0 (the sum of the balance of the previously taxed earnings and profits accounts with respect to CFC2).

(B) *Increase to balance of RGI account.* Under §1.245A-9(d)(11), US1 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. On November 30, 2019 (the last day of CFC2's taxable year), the

balance of the RGI account (which is initially zero) is increased by \$10x, the sum of the \$6x and \$4x amortization deductions of CFC2 for its taxable year ending November 30, 2019. See §1.245A-7(c)(4)(i). Each of the amortization deductions is taken into account for this purpose because, but for §1.951A-2(c)(5)(i), the deduction would have decreased CFC2's tested income or increased or given rise to a tested loss of CFC2. See §1.245A-7(c)(4)(i).

(C) *Reduction in balance of extraordinary disposition account.* Pursuant to §1.245A-7(c)(1), US1's extraordinary disposition account with respect to CFC1 is reduced by \$10x, the lesser of the amount described in §1.245A-7(c)(1)(i) with respect to US1 for CFC2's taxable year ending November 30, 2019 (\$25x), and the balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 (\$10x, determined as of November 30, 2019, but without regard to the application of §1.245A-7(c)(4)(ii) for the taxable year of CFC2 ending on that date). See §1.245A-7(c)(1). The \$10x reduction in the balance of US1's extraordinary disposition account occurs on December 31, 2019, the last day of US1's taxable year that includes November 30, 2019 (the last day of CFC2's taxable year). See §1.245A-9(c)(3).

(D) *Reduction in balance of RGI account.* On November 30, 2019 (the last day of CFC2's taxable year), the balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 is decreased by \$10x, the amount of the reduction, pursuant to §1.245A-7(c)(1) section and by reason of the RGI account, to US1's extraordinary disposition account with respect to CFC1. See §1.245A-7(c)(4)(ii). Therefore, following that reduction, the balance of the RGI account is zero (\$10x - \$10x).

(iii) *Alternative facts in which the reduction is limited by earnings and profits.* The facts are the same as in paragraph (c)(3)(i) of this section (*Example 3*), except that CFC2 has a \$5x deficit in its earnings and profits as of the end of its taxable year ending November 30, 2019. In this case—

(A) The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is \$5x, computed as -\$5x (CFC2's deficit in earnings and profits as of November 30, 2019) plus \$10x (the sum of the \$6x and \$4x amortization deductions of CFC2), see §1.245A-7(c)(3);

(B) The amount described in §1.245A-7(c)(1)(i) with respect to US1 for CFC's taxable year ending November 30, 2019, is \$5x, computed as the excess of \$5x (the adjusted earnings) over \$0 (the sum of the balance of the previously taxed earnings and profits accounts with respect to CFC2), see §1.245A-7(c)(1)(i);

(C) On December 31, 2019, US1's extraordinary disposition account with respect to CFC1 is reduced by \$5x, the lesser of the amount described in §1.245A-7(c)(1)(i) with respect to US1 for CFC2's taxable year ending November 30, 2019 (\$5x), and the balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 (\$10x, determined as of November 30, 2019, but without regard to the application of §1.245A-8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date), see §§1.245A-7(c)(1) and 1.245A-9(c)(3); and

(D) On November 30, 2019 (the last day of CFC2's taxable year), the balance of US1's RGI account with respect to CFC2 is decreased by \$5x (the amount of the reduction, pursuant to §1.245A-7(c)(1) and by reason of the RGI account, to US1's extraordinary disposition account with respect to CFC1) and, therefore, following such reduction, the balance of the RGI account is \$5x (\$10x - \$5x), see §1.245A-7(c)(4)(ii).

(4) *Example 4. Reduction to extraordinary disposition accounts limited by §1.245A-8(c)(6)*—(i) *Facts.* The facts are the same as in paragraph (c)(3)(iii) of this section (*Example 3*, alternative facts in which the reduction is limited by earnings and profits) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that US1 also owns 100% of the stock of US2, which owns 100% of the stock of CFC3, and on November 30, 2018, in a transaction that was an extraordinary disposition, CFC3 sold an item of specified property ("Item 3") to CFC2 in exchange for \$200x of cash. Item 3 had a basis of \$0 in the hands of CFC3 immediately before the sale and, therefore, CFC3 recognized \$200x of gain as a result of the sale (\$200x - \$0). Item 3 has \$200x of disqualified basis under §1.951A-2(c)(5), and US2 has an extraordinary disposition account with respect to CFC3 with an initial balance of \$200x under §1.245A-5(c)(3)(i)(A). Moreover, during CFC2's taxable year beginning December 1, 2018, and ending November 30, 2019, the disqualified basis of Item 3 gives rise to a \$20x amortization deduction, which is allocated and apportioned to residual CFC gross income of CFC2 solely by reason of §1.951A-2(c)(5) (though, but for §1.951A-2(c)(5), would have been allocated and apportioned to gross tested income of CFC2). Further, as of the end of US1's 2018 taxable year, the balance of US1's basis benefit account with respect to its extraordinary disposition account with respect to CFC1 is \$0; similarly, as of the end of US2's 2018 taxable year, the balance of US2's basis benefit account with respect to its extraordinary disposition account with respect to CFC2 is \$0. Because CFC2 holds items of specified property that correspond to more than one extraordinary disposition account (that is, Item 1 and Item 2 correspond to US1's extraordinary disposition account with respect to CFC2, and Item 3 corresponds to US2's extraordinary disposition account with respect to CFC2), the condition of §1.245A-6(b)(2) is not satisfied. See §1.245A-6(b)(2)(ii)(C)(3). US1 and US2 therefore apply §1.245A-8 (rules for complex cases) for their 2018 taxable years.

(ii) *Analysis.* Pursuant to §1.245A-8(c)(1), US1's extraordinary disposition account with respect to CFC1 is, subject to the limitation in §1.245A-8(c)(6), reduced by the lesser of the amount described in §1.245A-8(c)(1)(i) with respect to US1, and the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1. See §1.245A-8(c)(1). Similarly, US2's extraordinary disposition account with respect to CFC3 is, subject to the limitation in §1.245A-8(c)(6), reduced by the lesser of the amount described in §1.245A-8(c)(1)(i) with respect to US2, and the RGI account of US2 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3. See §1.245A-8(c)(1). Paragraphs (c)(4)(ii)(A) through (F) of this section describe the determinations pursuant to §1.245A-8(c)(1).

(A) *Ownership requirement.* Each of US1 and US2 satisfy the ownership requirement of §1.245A-8(c)(5) for CFC2's taxable year ending November 30, 2019, because on the last day of that taxable year each is a United States shareholder with respect to CFC2. See §1.245A-8(c)(5).

(B) *Computation of adjusted earnings of CFC2, and amount described in §1.245A-8(c)(1)(i) with respect to US1 and US2.* The adjusted earnings of CFC2 for its taxable year ending November 30, 2019, is \$25x, computed as -\$5x (CFC2's deficit in earnings and profits as of November 30, 2019), plus \$30x (the sum of the \$6x, \$4x, and \$20x amortization deductions of CFC2). See §1.245A-8(c)(3). For CFC2's taxable year ending November 30, 2019, the amount described in §1.245A-8(c)(1)(i) with respect to US1 is \$25x, computed as the excess of the product of \$25x (the adjusted earnings) and 100% (the percentage of the stock of CFC2 that US1 and its domestic affiliate, US2, own), over \$0 (the sum of the balance of certain previously taxed earnings and profits accounts and hybrid deduction accounts). See §1.245A-8(c)(1)(i). Similarly, for CFC2's taxable year ending November 30, 2019, the amount described in §1.245A-8(c)(1)(i) with respect to US2 is \$25x, computed as the excess of the product of \$25x (the adjusted earnings) and 100% (the percentage of the stock of CFC2 that US2 and its domestic affiliate, US1, own), over \$0 (the sum of the balance of certain previously taxed earnings and profits accounts and hybrid deduction accounts). See §1.245A-8(c)(1)(i).

(C) *Increase to balance of RGI account.* As described in paragraph (c)(3)(ii)(B) of this section, US1 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1, and the balance of the RGI account is \$10x on November 30, 2019 (the last day of CFC2's taxable year). Similarly, US2 has an RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3, and the balance of the RGI account is \$20x on November 30, 2019 (reflecting a \$20x increase to the balance of the account for the \$20x amortization deduction of CFC2 for its taxable year ending November 30, 2019). See §1.245A-8(c)(4)(i).

(D) *Reduction in balance of extraordinary disposition accounts but for §1.245A-8(c)(6).* But for the application of §1.245A-8(c)(6), US1's extraordinary disposition account with respect to CFC2 would be reduced by \$10x, which is the lesser of \$25x, the amount described in §1.245A-8(c)(1)(i) with respect to US1 for CFC2's taxable year ending November 30, 2019, and \$10x, the balance of the RGI account of US1 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 (determined as of November 30, 2019, but without regard to the application of §1.245A-8(c)(4)(i)(B) for the taxable year of CFC2 ending on that date). See §1.245A-8(c)(1)(i) and (ii). Similarly, but for the application of §1.245A-8(c)(6), US2's extraordinary disposition account with respect to CFC3 would be reduced by \$20x, which is the lesser of \$25x, the amount described in §1.245A-8(c)(1)(i) with respect to US2 for CFC2's taxable year ending November 30, 2019, and \$20x, the balance of the RGI account of US2 with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3 (determined as of November 30, 2019, but without regard to the application of §1.245A-8(c)(4)(i)(B)

for the taxable year of CFC2 ending on that date). See §1.245A-8(c)(1)(i) and (ii).

(E) *Application of limitation of §1.245A-8(c)(6).* As described in paragraph (c)(4)(ii)(D) of this section, but for the application of §1.245A-8(c)(6), there would be a total of \$30x of reductions to US1's extraordinary disposition account with respect to CFC1, and US2's extraordinary disposition account with respect to CFC3, by reason of the application of §1.245A-8(c)(1) with respect to CFC2's taxable year ending November 30, 2019. Because that \$30x exceeds the amount described in §1.245A-8(c)(1)(i) with respect to US1 and US2 (\$25x)—

(1) US1's extraordinary disposition account with respect to CFC1 is reduced by \$7.86x, computed as \$10x (the reduction that would occur but for §1.245A-8(c)(6)) less the product of \$5x (the excess amount, computed as \$30x, the total reductions that would occur but for the application of §1.245A-8(c)(6), less \$25x, the amount described in §1.245A-8(c)(1)(i)) and a fraction, the numerator of which is \$150x (the balance of US1's extraordinary disposition account with respect to CFC1) and the denominator of which is \$350x (\$150x, the balance of US1's extraordinary disposition account with respect to CFC1, plus \$200x, the balance of US2's extraordinary disposition account with respect to CFC3), see §1.245A-8(c)(6); and

(2) US2's extraordinary disposition account with respect to CFC3 is reduced by \$17.14x, computed as \$20x (the reduction that would occur but for §1.245A-8(c)(6)) less the product of \$5x (the excess amount, computed as \$30x, the total reductions that would occur but for the application of §1.245A-8(c)(6), less \$25x, the amount described in §1.245A-8(c)(1)(i)) and a fraction, the numerator of which is \$200x (the balance of US2's extraordinary disposition account with respect to CFC3) and the denominator of which is \$350x (\$150x, the balance of US1's extraordinary disposition account with respect to CFC1, plus \$200x, the balance of US2's extraordinary disposition account with respect to CFC3), see §1.245A-8(c)(6) of this section.

(F) *Reduction in balance of RGI accounts.* On November 30, 2019 (the last day of CFC2's taxable year)—

(1) The balance of US1's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC1 is decreased by \$7.86x (the amount of the reduction, pursuant to §1.245A-8(c)(1) and by reason of the RGI account, to US1's extraordinary disposition account with respect to CFC1) and, thus, following that reduction, the balance of the RGI account is \$2.14x (\$10x - \$7.86x), see §1.245A-8(c)(4)(i)(B); and

(2) The balance of US2's RGI account with respect to CFC2 that relates to its extraordinary disposition account with respect to CFC3 is decreased by \$17.14x (the amount of the reduction, pursuant to §1.245A-8(c)(1) and by reason of the RGI account, to US2's extraordinary disposition account with respect to CFC3) and, thus, following that reduction, the balance of the RGI account is \$2.86x (\$20x - \$17.14x), see §1.245A-8(c)(4)(i)(B).

(5) *Example 5. Computation of duplicate DQB*—(i) *Facts.* The facts are the same as in paragraph (c)(1)(i) of this section (*Example 1*) (and the results are the same as in paragraph (c)(1)(ii)(A) of this section), except that CFC1 does not make any distribu-

tion to US1, and on November 30, 2018, immediately after the Disqualified Transfer, CFC2 transfers Item 1 to newly-formed CFC3 solely in exchange for the sole share of stock of CFC3 (the contribution, “Contribution 1,” and the share of stock of CFC3, the “CFC3 Share”) and, immediately after Contribution 1, CFC3 transfers Item 1 to newly-formed CFC4 solely in exchange for the sole share of stock of CFC4 (the contribution, “Contribution 2,” and the share of stock of CFC4, the “CFC4 Share”). Pursuant to section 358(a)(1), CFC2’s basis in its share of stock of CFC3 is \$90x, and CFC3’s basis in its share of stock of CFC4 is \$90x basis. As a result of Contribution 1, the condition of §1.245A-6(b)(2) is not satisfied, because on at least one day of CFC2’s taxable year ending on November 30, 2018 (which ends within US1’s 2018 taxable year), CFC2 does not hold Item 1. See §1.245A-6(b)(2)(ii)(C)(I). US1 therefore applies §1.245A-8 (rules for complex cases) for its 2018 taxable year. See §1.245A-6(b).

(ii) *Analysis—(A) Application of exchanged basis rule under section 951A to Contribution 1 and Contribution 2.* As a result of Contribution 1, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(ii), the disqualified basis of CFC3 Share includes the disqualified basis of Item 1 (\$90x), and therefore the disqualified basis of CFC3 Share is \$90x. Similarly, as a result of Contribution 2, pursuant to §1.951A-3(h)(2)(ii)(B)(2)(ii), the disqualified basis of CFC4 Share also includes the disqualified basis of Item 1 (\$90x), and therefore the disqualified basis of CFC4 Share is \$90x.

(B) *Determination of duplicate DQB of CFC3 Share as a result of Contribution 1.* Because the disqualified basis of CFC3 Share includes the disqualified basis of Item 1, CFC3 Share is an item of exchanged basis property that relates to Item 1. See §1.245A-8(d)(2)(ii). In addition, because CFC3 Share is an item of exchanged basis property that relates to Item 1 (which corresponds to US1’s extraordinary disposition account with respect to CFC1), CFC3 Share is, for purposes of §1.245A-8, treated as an item of specified property that corresponds to US1’s extraordinary disposition account with respect to CFC1. See §1.245A-8(d)(2)(i). Further, the duplicate DQB of CFC3 Share as to Item 1 is \$90x, the portion of the disqualified basis of CFC3 Share that includes Item 1’s disqualified basis of \$90x. See §1.245A-8(d)(2)(iii)(A).

(C) *Determination of duplicate DQB of CFC4 Share as a result of Contribution 2.* For reasons similar to those described in paragraph (c)(5)(ii)(B) of this section, CFC4 Share is an item of exchanged basis property that relates to Item 1, CFC4 is treated for purposes of §1.245A-8 as an item of specified property that corresponds to US1’s extraordinary disposition account with respect to CFC1, and the duplicate DQB of CFC4 Share as to Item 1 is \$90x.

(D) *Determination of duplicate DQB of CFC3 Share as a result of Contribution 2.* Because the disqualified basis of CFC3 Share and the disqualified basis of CFC4 Share each includes \$90x of the disqualified basis of Item 1 and CFC3 receives the CFC4 Share in Contribution 2, the \$90x of disqualified basis of CFC3 Share is attributable to the \$90x of disqualified basis of CFC4 Share, and CFC3 Share is an item of exchanged basis property that relates to CFC4 Share. See §1.245A-8(d)(2)(i) and (d)(2)(iii)

(C). In addition, the duplicate DQB of CFC3 Share as to CFC4 Share is \$90x. See §1.245A-8(d)(2)(iii)(A).

(E) *Application of duplicate basis rules in §1.245A-8(b)(5).* For purposes of computing the fraction described in §1.245A-8(b)(1)(ii), if US1’s extraordinary disposition account with respect to CFC1 were to give rise to an extraordinary disposition amount or a tiered extraordinary disposition amount during US1’s 2018 taxable year, then the duplicate DQB of CFC3 Share and the duplicate DQB of CFC4 Share would not be taken into account, because the disqualified basis of Item 1 (an item of specified property that corresponds to US1’s extraordinary disposition account and as to which each of CFC3 Share and CFC4 share relates) would be taken into account. See §1.245A-8(b)(1)(ii) and (b)(5)(i)(A). Accordingly, in such a case, for US1’s 2018 taxable year, the numerator of the fraction described in §1.245A-8(b)(1)(ii) would reflect only the disqualified basis of Item 1 or Item 2, as applicable, and the denominator would reflect only the sum of the disqualified basis of each of Item 1 and Item 2. See §1.245A-8(b)(1)(ii) and (b)(5)(i)(A). Furthermore, to the extent there were to be a reduction under §1.245A-8(b)(1) to the disqualified basis of Item 1, then the duplicate DQB of CFC4 Share would be reduced (but not below zero) by the product of the reduction to the disqualified basis of Item 1 and a fraction, the numerator of which would be \$90x (the duplicate DQB of CFC4 Share), and the denominator of which would also be \$90x (the duplicate DQB of CFC4 Share). See §1.245A-8(b)(5)(i)(B). The \$90x of duplicate DQB of CFC3 Share would be excluded from the denominator of the fraction described in the previous sentence because it is attributable to the \$90x of duplicate DQB of CFC4 Share. See §1.245A-8(b)(5)(i)(B)(2) (last sentence). For reasons similar to those described in this paragraph (c)(4)(ii)(E) with respect to the application of §1.245A-8(b)(5)(i)(B) to CFC4 Share, the duplicate DQB of CFC3 Share would be reduced (but not below zero) by the product of the reduction to the disqualified basis of Item 1 and a fraction, the numerator of which would be \$90x, and the denominator of which would also be \$90x.

§1.245A-11 Applicability dates.

(a) *In general.* Sections 1.245A-6 through 1.245A-11 apply to taxable years of a foreign corporation beginning on or after December 1, 2020 and to taxable years of section 245A shareholders in which or with which such taxable years end.

(b) *Exception.* Notwithstanding paragraph (a) of this section, a taxpayer may choose to apply §§1.245A-6 through 1.245A-11 for a taxable year of a foreign corporation beginning before December 1, 2020 and to a taxable year of a section 245A shareholder in which or with which such taxable year ends, provided that the taxpayer and all persons bearing a relationship to the taxpayer described in section 267(b) or 707(b) apply §§1.245A-6

through 1.245A-11, in their entirety, and §1.6038-2(f)(18) for all such taxable years and any subsequent taxable years beginning before December 1, 2020.

Par. 4. Section 1.951A-2 is amended by:

1. Redesignating paragraph (c)(5)(iv) as paragraph (c)(5)(v).
2. Adding new paragraph (c)(5)(iv).
3. In newly redesignated paragraph (c)(5)(v)(B)(I), removing the language “(c)(5)(iv)(A)(I)” and adding the language “(c)(5)(v)(A)(I)” in its place.
4. In newly redesignated paragraph (c)(5)(v)(C)(I), removing the language “(c)(5)(iv)(B)(I)” and adding the language “(c)(5)(v)(B)(I)” in its place.
5. Redesignating paragraph (c)(6)(iv) as paragraph (c)(6)(v).
6. Adding new paragraph (c)(6)(iv).
7. In newly redesignated paragraph (c)(6)(v)(B)(I), removing the language “(c)(6)(iv)(A)(I)” and adding the language “(c)(6)(v)(A)(I)” in its place.

The additions read as follows:

§1.951A-2 Tested income and tested loss.

* * * * *

(c) * * *

(5) * * *

(iv) *Reductions to disqualified basis pursuant to coordination rules.* See §1.245A-7(b) or §1.245A-8(b), as applicable, for reductions to disqualified basis resulting from the application of §1.245A-5.

* * * * *

(6) * * *

(iv) *Reductions to disqualified payments pursuant to coordination rules.* See §1.245A-5(j)(8) and §1.245A-7(b) or §1.245A-8(b), as applicable, for reductions to disqualified payments resulting from the application of §1.245A-5.

* * * * *

Par. 5. Section 1.6038-2 is amended by adding paragraphs (f)(17) and (18) and (m)(5) to read as follows:

§1.6038-2 *Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.*

* * * * *

(f) * * *

(17) *Reporting of disqualified basis and disqualified payments.* If for the annual accounting period of a corporation it holds an item of property having disqualified basis within the meaning of §1.951A-3(h)(2)(ii) or §1.951A-2(c)(5), or incurs an item of deduction or loss related to a disqualified payment (within the meaning of §1.951A-2(c)(6)(ii)(A)), then Form 5471 (or successor form) must contain such information about the disqualified basis, or such information relating to the disqualified payment, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

(18) *Adjustments to extraordinary disposition accounts and disqualified basis.* If for the annual accounting period a section 245A shareholder of the corporation reduces its extraordinary disposition account pursuant to §1.245A-7(c) or §1.245A-8(c), as applicable, or the corporation reduces the disqualified basis in an item of specified property pursuant to §1.245A-7(b) or §1.245A-8(b), as applicable, then Form 5471 (or a successor form) must contain such information about the reduction to the extraordinary disposition account or disqualified basis, as applicable, in the form and manner and to the extent prescribed by the form, instructions to the form, publication, or other guidance published in the Internal Revenue Bulletin.

(m) ***

(5) *Special rule for paragraphs (f)(17) and (18) of this section.* Paragraphs (f)(17) and (18) of this section apply with respect to information for annual accounting periods beginning after December 1, 2020. In addition, as provided in §1.245A-11(b), paragraph (f)(18) of this section applies with respect to information for an annual accounting period that includes a taxable year for which a taxpayer has chosen to apply §§1.245A-6 through 1.245A-11 pursuant to §1.245A-11(b).

Sunita Lough,
Deputy Commissioner for Services
and Enforcement.

Approved: November 13, 2020

David J. Kautter,
Assistant Secretary of the Treasury
(Tax Policy).

(Filed by the Office of the Federal Register on November 25, 2020, 4:45 p.m., and published in the issue of the Federal Register for December 01, 2020, 85 F.R. 76960)

26 CFR 1.1031(a)-3

T.D. 9935

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Statutory Limitations on Like-Kind Exchanges

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance under section 1031 of the Internal Revenue Code (Code) to implement recent statutory changes to that section. More specifically, the final regulations amend the current like-kind exchange regulations to add a definition of real property to implement statutory changes limiting section 1031 treatment to like-kind exchanges of real property. The final regulations also provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in an otherwise qualifying like-kind exchange of real property. The final regulations affect taxpayers that exchange business or investment property for other business or investment property, and that must determine whether the exchanged properties are real property under section 1031.

DATES: *Effective date:* These final regulations are effective on December 2, 2020.

Applicability dates: These regulations generally apply to exchanges beginning after December 2, 2020. See §§1.1031(a)-

1(e)(2), 1.1031(a)-3(c), and 1.1031(k)-1(g)(9). However, the regulations in §§1.168(i)-1(e)(2)(viii)(A) and 1.168(i)-8(c)(4)(i) apply to taxable years beginning after December 2, 2020. See §§1.168(i)-1(m)(5) and 1.168(i)-8(j)(5).

FOR FURTHER INFORMATION CONTACT: Edward C. Schwartz at (202) 317-4740, or Suzanne R. Sinno at (202) 317-4718 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Overview

This document amends the Income Tax Regulations (26 CFR Part 1, as revised April 1, 2020) under section 1031 (current regulations). The amendments to the current regulations (final regulations) implement statutory amendments to section 1031 made by section 13303 of Public Law 115-97, 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 13303(c) of the TCJA amended section 1031 to limit its application to exchanges of real property for exchanges completed after December 31, 2017, subject to a transition rule for certain exchanges in which property had been transferred before January 1, 2018. To implement these statutory changes, the final regulations limit the application of the like-kind exchange rules under section 1031 to exchanges of real property, add a definition of real property, and adapt an existing incidental property exception to apply to a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in the exchange.

II. Section 1031 after the TCJA

As amended by the TCJA, section 1031(a) provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment (relinquished real property) if the relinquished real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment (replacement real property). The legislative history to the TCJA

amendments to section 1031 provides that Congress “intended that real property eligible for like-kind exchange treatment under present law will continue to be eligible for like-kind exchange treatment under the [amended] provision.” H.R. Conf. Rept. 115-466, at 396, fn. 726 (2017) (Conference Report). However, left unchanged by the TCJA, section 1031(b) provides that a taxpayer must recognize gain to the extent of money and non-like-kind property the taxpayer receives in an exchange.

III. Current Regulations Regarding “Like Kind”

The need to determine whether the relinquished real property and the replacement real property are of a like kind continues to exist after the changes to section 1031 made by the TCJA. Current §1.1031(a)-1(b) provides that “like kind” refers to the nature or character of the real property and not to its grade or quality. The fact that any real property involved is improved or unimproved is not material in determining whether real property is of like kind. Under current §1.1031(a)-1(c), examples of exchanges of real property of a like kind include an exchange of a leasehold interest in a fee with 30 years or more to run for real estate.

IV. Identification of Exchanged Properties

Under section 1031(a)(3), unchanged by the TCJA, real property a taxpayer receives in an exchange is not of like-kind to the relinquished property unless, within 45 days after the taxpayer’s transfer of the relinquished real property, the real property is identified as replacement real property to be received in the exchange. Current §1.1031(k)-1(c)(4) provides a limit on the number of properties, or the fair market value of the properties, a taxpayer may identify to meet the requirements of section 1031(a)(3). However, under current §1.1031(k)-1(c)(5), property is disregarded in evaluating the identification rules if it is incidental to a larger item of property and therefore, is not treated as property separate from the larger item. Property is incidental to a larger property if, in standard commercial transactions, the property is typically transferred with the

larger item of property, and the aggregate fair market value of all of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

V. Recognition of Gain or Loss on Actual or Constructive Receipt of Non-like-kind Property

Under current §1.1031(k)-1(f)(1) and (2), if a taxpayer actually or constructively receives money or non-like-kind property for the relinquished property before the taxpayer receives like-kind replacement real property, the transaction is a sale or taxable exchange and not a like-kind exchange, even though the taxpayer may ultimately receive like-kind replacement real property. Current §1.1031(k)-1(g)(2) through (5) provides safe harbors, the use of which results in a taxpayer not being considered in actual or constructive receipt of the consideration for the relinquished property.

Under current §1.1031(k)-1(g)(4)(i), in the case of a taxpayer’s transfer of relinquished property involving a qualified intermediary, the determination of whether the taxpayer is in actual or constructive receipt of money or non-like-kind property is made as if the qualified intermediary is not the agent of the taxpayer. However, current §1.1031(k)-1(g)(4)(i) applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer’s rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property held by the qualified intermediary. Current §1.1031(k)-1(g)(7) lists items received in an exchange that are disregarded in determining whether a taxpayer’s rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property are expressly limited.

VI. Proposed Regulations

On June 12, 2020, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-117589-18) in the **Federal Register** (85 FR 35835) containing proposed regulations under section 1031 (proposed regulations). The Treasury Department and the IRS received 21 written

comments in response to the notice of proposed rulemaking. All comments were considered and are available at <http://www.regulations.gov> or upon request. A public hearing on the proposed regulations was neither requested nor held. After full consideration of the comments received, this Treasury decision adopts the proposed regulations with modifications in response to such comments, as described in the Summary of Comments and Explanation of Revisions following this Background.

Summary of Comments and Explanation of Revisions

I. Overview

The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. In particular, the final regulations revise the definition of “real property” in the proposed regulations to provide that property is classified as real property for section 1031 purposes if, on the date it is transferred in an exchange, the property is real property under the law of the State or local jurisdiction in which that property is located. The final regulations also revise the proposed definition of real property to eliminate, with regard to both tangible and intangible properties, any consideration of whether the particular property contributes to the production of income unrelated to the use or occupancy of space (referred to as the “purpose or use test,” as defined in part II.B.1 of this Summary of Comments and Explanation of Revisions). Finally, in §1.1031(a)-3(a)(7), the final regulations retain the language of the proposed regulations clarifying that the rules of these final regulations apply only for purposes of section 1031, and that no inference is intended with respect to the classification or characterization of property for other purposes of the Code.

II. Definition of Real Property

A. State or local law definitions of real property

1. Approach of the Proposed Regulations

Section 1031 does not provide a definition for the term “real property.” As noted

in part II of the Background section, the Conference Report provides that Congress intended real property that was eligible for like-kind exchange treatment prior to the enactment of the TCJA to continue to be eligible for like-kind exchange treatment after its enactment. See Conference Report, at 396, fn. 726. Specifically, with regard to the applicability of State law for real property determinations, the Conference Report sets forth the following example: “a like-kind exchange of real property includes an exchange of shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) [of the Code] if at the time of the exchange such shares have been recognized by the highest court or statute of the State in which the company is organized as constituting or representing real property or an interest in real property” (Conference Report Example). *Id.* Accordingly, due to the absence of a statutory definition for the term “real property” in section 1031, the Treasury Department and the IRS based the proposed definition of real property upon the Conference Report Example.

Under proposed §1.1031(a)-3(a)(1), State law controls whether shares in a mutual ditch, reservoir, or irrigation company are real property for purposes of section 1031. Aside from those enumerated asset types, the proposed regulations provide that State or local law definitions were not controlling for purposes of determining whether property is real property for section 1031 purposes. See proposed §1.1031(a)-3(a)(1). The intent of the Treasury Department and the IRS in proposing a rule that expressly applied State or local law in this manner was to provide a definition of real property for purposes of section 1031 “in a manner consistent with the scope described by Congress in the Conference Report.” See the preamble to the proposed regulations at 85 FR 35836.

2. Consideration of Comments and Revision of “Real Property” Definition

Commenters generally critiqued the apparent scope of the application of State and local law in the proposed regulations for purposes of defining real property. These commenters contended that, prior to enactment of the TCJA, State and local law classification of a property often was

the determining factor in characterizing property as real or personal under section 1031. With regard to the Conference Report Example, the commenters asserted that the reference to “shares in a mutual ditch, reservoir, or irrigation company” merely constituted a set of examples that Congress provided to broadly indicate that real property eligible for like-kind treatment under law prior to enactment of the TCJA will continue to be eligible following the TCJA’s amendment to section 1031. Consequently, the commenters recommended that the final regulations conform to that intent by expanding the rules to rely significantly, or wholly, on State-law classifications for all assets, rather than limiting such reliance to shares in a mutual ditch, reservoir, or irrigation company. Additionally, commenters suggested that the final regulations should include multiple examples of instances in which taxpayers may rely on State or local law for purposes of classifying property as real or personal.

In light of these comments, the Treasury Department and the IRS have reconsidered the degree to which State or local law determinations of real property should be controlling for defining real property for section 1031 purposes. As a result of that reconsideration, the final regulations provide generally that property is real property for purposes of section 1031 if, on the date it is transferred in an exchange, that property is classified as real property under the law of the State or local jurisdiction in which that property is located (State and local law test). The State and local law test applies to both tangible and intangible property classifications.

However, consistent with Congressional intent that “real property eligible for like-kind exchange treatment” under the law in effect prior to enactment of the TCJA will continue to be eligible for like-kind exchange treatment after enactment of the TCJA, property ineligible for like-kind exchange treatment prior to enactment of the TCJA remains ineligible, including real property that was excluded from the application of section 1031. See Conference Report at 396, fn. 726. Prior to amendment by the TCJA, former section 1031(a)(2) explicitly excluded certain assets from the application of section 1031. Accordingly, the final regulations exclude

from the definition of real property the intangible assets listed in section 1031(a)(2) prior to its amendment by the TCJA, regardless of the classification of the property under State or local law, because such property never was “real property eligible for like-kind exchange treatment” prior to enactment of the TCJA. Conference Report at 396, fn. 726 (emphasis added).

In summary, under the final regulations, property is classified as real property for purposes of section 1031 if the property is (i) so classified under the State and local law test, subject to certain exceptions, (ii) specifically listed as real property in the final regulations, or (iii) considered real property based on all the facts and circumstances under the various factors provided in the final regulations. A determination that property is personal property under State or local law does not preclude the conclusion that property is real property as specifically listed in §1.1031(a)-3(a)(2)(ii) or (a)(2)(iii)(B) or under the factors listed in §1.1031(a)-3(a)(2)(ii)(C) or (a)(2)(iii)(B).

3. Chief Counsel Advice (CCA) 201238027

Multiple commenters who objected to the scope of State and local law determinations under the proposed regulations also asserted that the approach in the proposed regulations replicated the analysis in CCA 201238027 (April 17, 2012), particularly with regard to one of the fact patterns addressed therein regarding a steam turbine (Case 3). In Case 3, the Chief Counsel Advice disregarded State law that characterized the steam turbine as real property and held that the steam turbine was not of like kind to land because it did not have the same nature or character as land. Commenters objected to this conclusion, contending that the State law classification of the steam turbine as real property should be respected and, based on that classification, the steam turbine and the undeveloped land should be considered like-kind property.

These final regulations do not address whether exchanged properties are of like kind to one another. As a consequence of expressly including the State and local law test in the final regulations, the final regulations do not adopt the reasoning of

CCA 201238027 to the extent it suggests that State or local law is disregarded in determining whether property is real property under section 1031.

4. Additional Comments Regarding the Application of State and Local Law

In connection with the State and local law test under the final regulations, the Treasury Department and the IRS have considered numerous additional comments. For instance, one commenter recommended that any asset determined to be essentially the same as an asset classified as a real property for purposes of section 1031 also should automatically be treated as real property for purposes of section 1031. For example, if one asset (Property A) is classified as real property under the State or local law of State X, an asset located in a different jurisdiction (Property B) that is essentially the same as Property A also should be classified as real property for section 1031 purposes, irrespective of whether Property B is classified as real property under (i) the law of the State or local jurisdiction in which Property B is located or (ii) the real property definition and factors under the proposed regulations.

The final regulations do not adopt this suggestion. First, the Treasury Department and the IRS have determined that the “essentially the same” standard recommended by the commenter would be difficult for taxpayers to apply and the IRS to administer with certainty. In addition, the analysis advocated by the commenter is conceptually similar to the analysis applied by CCA 201238027, which, based on several other comments, the Treasury Department and the IRS have determined to be inconsistent with the State and local law test provided in the final regulations.

A commenter also requested that the final regulations classify as real property all property that was treated as real property for section 1031 purposes at any time between May 22, 2008, and the effective date of the TCJA. May 22, 2008, is the effective date of former section 1031(i), which treats shares in certain mutual ditch companies as real property for section 1031 purposes. The commenter reasoned that, because the treatment of mutual ditch company shares has been preserved by the

proposed regulations following the enactment of the TCJA, all property classified as real property as of May 22, 2008, also should be classified as real property under the final regulations.

The final regulations do not adopt the commenter’s suggestion. The Treasury Department and the IRS have determined that a rule that fixes property classifications under State or local laws as of a date certain would add complexity as the post-enactment period of the TCJA continues to lengthen. Given that the final regulations have broadened the applicability of State and local real property classification for purposes of section 1031 qualification, the Treasury Department and the IRS have determined that the perpetually increasing complexity of such a rule would significantly outweigh any potential benefits of the commenter’s suggestion.

B. Purpose or use test

1. Approach of the Proposed Regulations

Under proposed §1.1031(a)-3(a)(1), real property includes land and improvements to land, and improvements to land include both inherently permanent structures and the structural components of inherently permanent structures. Inherently permanent structures are buildings or other structures that are permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. See proposed §1.1031(a)-3(a)(2)(ii)(A). A list of structures that qualify as buildings or as other inherently permanent structures is provided in proposed §1.1031(a)-3(a)(2)(ii)(B) and (C). A structural component is any distinct asset, as defined in the proposed regulations, that is a constituent part of, and integrated into, an inherently permanent structure. See proposed §1.1031(a)-3(a)(2)(iii)(A). Proposed §1.1031(a)-3(a)(2)(iii)(B) provides examples of items that are structural components under section 1031.

The proposed regulations also consider the function of property in determining whether the property is real property for section 1031 purposes (purpose or use test). In particular, neither tangible property, such as machinery or equipment, nor intangible property, such as licenses or permits, is classified as real property

under the proposed regulations if the property contributes to the production of income unrelated to the use or occupancy of space, irrespective of any other factor under the proposed regulations. See proposed §1.1031(a)-3(a)(2)(ii)(D) (regarding machinery and equipment) and 1.1031(a)-3(a)(5) (regarding intangible property). For example, a gas line installed for the sole purpose of providing fuel to fryers and ovens in a restaurant is not a constituent part of an inherently permanent structure and therefore not real property under the proposed regulations. See also proposed §1.1031(a)-3(b)(12) (providing a similar example with regard to a license to operate a casino business, which is an intangible property). The proposed regulations requested comments on whether the purpose or use test is appropriate to use as the basis for determining whether property qualifies as real property for section 1031 purposes.

2. Summary of Comments Received

Commenters uniformly disagreed with the purpose or use test and advocated that it be omitted from the final regulations. According to these commenters, the purpose or use test improperly narrows the scope of the definition of real property for section 1031 purposes and, if adopted in the final regulations, would treat certain types of property that have historically been treated as real property for section 1031 purposes as personal property contrary to the directive of Congress in the Conference Report. See Conference Report, at 396, fn. 726.

In addition, commenters contend that machinery and equipment should not be disqualified as an inherently permanent structure, and thus as real property, merely because the machinery or equipment is used in the production of income unrelated to use or occupancy of space. Instead, the commenters asserted that if such property is inherently permanent, the property should be treated as real property for purposes of section 1031, regardless of its purpose or use or the type of income it generates. Therefore, according to the commenters, permanently affixed items such as gas lines, cooling units, and piping should be treated as real property without regard to whether those items comprise

part of an income-generating structure. The commenters also recommended that the final regulations provide revised examples to reflect the position that the real property characterization of a particular asset is based on the degree to which the item is permanently affixed and not on its purpose and use.

One commenter also emphasized that the purpose or use test would prove burdensome for small businesses and individual taxpayers because that test would require them to expend resources on cost segregation studies to determine which items of machinery and equipment are personal and which are real property. According to the commenter, such expenses would be eliminated if real property determinations are based on permanent affixation and not purpose or use. Finally, the commenter noted that inclusion of the purpose or use test in the final regulations would be problematic because neither section 1031 nor the regulations under section 1031 provide a definition of machinery. However, the term “machinery” is not necessary if, as this commenter recommended, real property determinations for an asset are based on the degree to which the asset is permanently affixed and not its purpose or use.

3. Elimination of Proposed Purpose or Use Test

The Treasury Department and the IRS agree with the commenters and have revised the final regulations to eliminate a purpose or use test for tangible property. Consequently, with regard to tangible property, if such property is permanently affixed to real property and will ordinarily remain affixed for an indefinite period of time, the property is generally an inherently permanent structure and thus real property for section 1031 purposes, irrespective of the purpose or use of the property or whether it contributes to the production of income. A structural component likewise is characterized as real property under the final regulations if it is integrated into an inherently permanent structure, regardless of whether the structural component contributes to the production of income. Accordingly, under the final regulations, items of machinery and equipment are characterized as real property if they com-

prise an inherently permanent structure, a structural component, or are real property under the State or local law test.

The Treasury Department and the IRS received no comments regarding the application of the proposed purpose or use test to real property classifications of intangible property. However, the Treasury Department and the IRS have determined that many of the comments pertaining to the purpose or use test with regard to tangible property equally apply to classifications of intangible property. As a result, under the final regulations, whether intangible property produces or contributes to the production of income other than consideration for the use or occupancy of space is not considered in determining whether intangible property is real property for section 1031 purposes. However, the purpose of the intangible property remains relevant to the real property determination.

C. Revisions to the definition of inherently permanent structure

Proposed §1.1031(a)-3(a)(2)(ii)(A) defines the term “inherently permanent structures” to mean “any building or other structure that is a distinct asset (within the meaning of [proposed §1.1031(a)-3(a)(4)]) and is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time.” One commenter highlighted that the proposed regulations do not define the phrases “permanently affixed” or “indefinite period of time” for purposes of defining “inherently permanent structure,” other than providing that affixation to real property may be accomplished by weight alone. See proposed §1.1031(a)-3(a)(2)(ii)(C). The commenter noted that §1.856-10(d)(2)(i) provides that, “[i]f the affixation is reasonably expected to last indefinitely based on all the facts and circumstances, the affixation is considered permanent.” As a result, the commenter recommended that the final regulations clarify the meaning of these terms, including by adding the above-quoted language in §1.856-10 to explain the phrase “permanently affixed.”

The Treasury Department and the IRS agree with the commenter’s suggestion to incorporate the language provided in §1.856-10(d)(2)(i) to provide additional

clarity regarding the meaning of “permanently affixed” and have revised the final regulations accordingly.

D. Comments regarding offshore platforms and pipelines, and related example

Proposed §1.1031(a)-3(a)(2)(ii)(C) specifically lists offshore drilling platforms and oil and gas pipelines as inherently permanent structures, and therefore such property is defined as real property. The proposed regulations also provide an example addressing a pipeline transmission system comprised of underground pipelines, isolation valves and vents, pressure control and relief valves, meters, and compressors. See proposed §1.1031(a)-3(b)(10) (Example 10). Example 10 concludes that the meters and compressors are not real property because (i) they are not time consuming and expensive to install and remove from the pipelines, (ii) they are not designed specifically for the particular pipelines for which they are a part, and (iii) their removal does not cause damage to the asset or the pipelines if removed. Based on the same analysis, Example 10 concludes that isolation valves and vents, and pressure control and relief valves are real property for section 1031 purposes.

One commenter suggested that the final regulations should remove the adjective “drilling” from “offshore drilling platform” as listed as an inherently permanent structure in proposed §1.1031(a)-3(a)(2)(ii)(C). For support, the commenter stated that an offshore platform used for production is structurally similar to an offshore platform used for drilling, and therefore the term should be appropriately broadened. As so modified, the term “offshore platform” would cover both offshore drilling platforms and offshore production platforms.

The commenter also provided additional recommendations regarding assets used in an oil and gas business. For example, the commenter suggested that the final regulations should explicitly provide that underground and above-ground pipelines are real property for section 1031 purposes. The commenter recommended that the final regulations characterize meters and compressors as real property. In contend-

ing that Example 10 provided an incorrect conclusion, the commenter explained that meters and compressors generally require substantial amounts of time and money to prepare, construct, and place in service due to unique circumstances affecting individual pipelines.

The Treasury Department and the IRS have clarified the final regulations based on the commenter's recommendations. As an initial matter, the final regulations delete "drilling" from the term "offshore drilling platform," as listed in proposed §1.1031(a)-3(a)(2)(ii)(C). The Treasury Department and the IRS agree that an offshore platform used for production likewise should be characterized as an inherently permanent structure because such property is structurally similar to an offshore platform used for drilling.

In addition, the final regulations contain a revised version of Example 10, renumbered as Example 9, to clarify the analysis and conclusions in the proposed example. With regard to an above-ground pipeline, an oil and gas pipeline is listed property in proposed §1.1031(a)-3(a)(2)(ii)(C) and is therefore real property, regardless of whether above or below ground. Whether particular meters or compressors are real property must be determined by their unique facts and circumstances. If under different circumstances the meters or compressors described in proposed Example 10, now Example 9, required substantial amounts of time and money to prepare, construct, and place in service due to unique circumstances affecting individual pipelines, the components would be real property for section 1031 purposes. Example 9 in the final regulations illustrates these rules.

E. Requests to list additional tangible assets as real property

1. Installed Appliances

One commenter requested that the final regulations expressly list as real property installed appliances (also referred to as "appliances in place"), including refrigerators, stoves, dishwashers, and microwave ovens. The commenter explained that, in certain regions of the United States, residential real property generally is sold with the appliances in place as part of the

sale. The commenter further stated that, in many like-kind exchanges of one-family rental properties, sellers (i) consider the appliances, furniture, and electrical fixtures remaining in the property to be part of the real property transaction, and (ii) count such items of property towards the amount of replacement property that must be acquired to avoid gain recognition under section 1031.

2. Sheds and Carports

One commenter recommended adding sheds and carports to the list of assets that are expressly included as buildings in proposed §1.1031(a)-3(a)(2)(ii)(B). The commenter contended that such structures generally take the form of buildings and, therefore, a specific listing as a building under the final regulations would increase certainty regarding exchanges involving such assets.

3. Wi-Fi Systems

Another commenter suggested that proposed §1.1031(a)-3(a)(2)(iii)(A) be revised to specifically list as structural components Wi-Fi systems, distributed antenna systems, and other integrated systems that may be installed in buildings to transmit and receive wireless signals and cellular service. The commenter asserted that such integrated systems are installed in buildings and inherently permanent structures, and often are as essential to the use of buildings as heating and electricity. Additionally, the commenter emphasized that such integrated systems generally require that the taxpayer hold a real property interest in conjunction with its installation of the system, and therefore should satisfy the definition of a structural component under the proposed regulations.

4. Trade Fixtures

One commenter recommended that "trade fixtures" be expressly listed as real property under the final regulations. The commenter noted that such items are semi-permanently affixed to real property and perform or support the performance of functions (including manufacturing, cooking, and decorative lighting) unrelated to basic building functions. Addition-

ally, the commenter asserted that trade fixtures have historically been treated as real property for State law purposes, except in instances in which there is a plan to remove or relocate them to a different property.

5. Final Regulations Do Not Specifically List the Requested Items as Real Property

After consideration of the commenters' recommendations, the Treasury Department and the IRS have determined that the final regulations should not specifically list any of these suggested assets as real property for purposes of section 1031. The final regulations are intended to provide tests under which taxpayers can evaluate the particular facts and circumstances of the property in question to determine with certainty whether particular property is characterized as real or personal property. To limit complexity of the final regulations, the characterization of the above-listed items in this part II.E is most appropriately determined based on the application of the State and local law test or the various factors in the final regulations.

Specifically, with regard to installed appliances, whether a seller considers an item transferred with real property to be part of the real property transaction is not a relevant factor in determining whether the item is real property for section 1031 purposes. Movable items, such as furniture, are personal property irrespective of the terms of the sales contract for the real property that is the subject of the sale. Those items, however, may be incidental personal property that, under the final regulations, is disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property held by a qualified intermediary are expressly limited as provided in §1.1031(k)-1(g)(6).

F. Requested clarifications regarding carpeting and wiring

One commenter requested clarification regarding whether carpeting in an office building, or other real property held for productive use in a trade or business or for investment, is considered real property or personal property under the final

regulations. Another commenter inquired whether wires installed within the walls of an office building are real property for section 1031 purposes if the wires were installed specifically for computer workstations that produce income for the business. The commenter acknowledged that the proposed regulations provide that wiring is a structural component, and therefore real property for purposes of section 1031, provided the wiring is a constituent part of, and integrated into, an inherently permanent structure.

The Treasury Department and the IRS appreciate the commenters' requests for clarification regarding the qualification of carpeting and wiring as inherently permanent structures or structural components. However, such qualification would be dependent upon a facts-and-circumstances analysis unique to the specific carpeting or wiring, as well as the classification of such items under applicable State or local law. As a result, the final regulations do not adopt the commenters' suggestions, but instruct taxpayers to apply the State and local law test or the various factors in the final regulations.

G. Requests to list additional intangible assets as real property

1. Stock in a Cooperative Housing Corporation

The proposed regulations provide that an interest in real property, including fee ownership, co-ownership, a leasehold, an option to acquire real property, an easement, or a similar interest, is real property for purposes of section 1031. See proposed §1.1031(a)-3(a)(1). One commenter suggested that this list of items be revised to include stock held by a person as a tenant-stockholder in a cooperative housing corporation. The commenter noted that the term "interests in real property" for purposes of regulations regarding real estate investment trusts (REITs) includes stock held by a person as a tenant-stockholder in a cooperative housing corporation. See §1.856-3(c).

2. Development Rights

One commenter requested that rights to develop land be expressly listed as real

property in final §1.1031(a)-3(a)(1). For support, the commenter emphasized that the IRS has published a private letter ruling that an exchange of a fee interest in real estate for development rights in real estate qualified as a like-kind exchange under section 1031. Accordingly, the commenter concluded that development rights should be specifically listed as real property in the final regulations.

3. Final Regulations Expressly List the Requested Items as Real Property

The Treasury Department and the IRS agree with the commenters' recommendations regarding stock in a cooperative housing corporation and land development rights. The intangible assets described in this part II.G have historically been characterized as real property. Accordingly, the final regulations have been revised to expressly list those intangible assets.

4. Licenses and Permits

Under the proposed regulations, a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure, and that is in the nature of a leasehold or easement, generally is an interest in real property under section 1031. See proposed §1.1031(a)-3(a)(5)(ii). One commenter contended that this language is too restrictive because it addresses only leaseholds and easements.

In response to this comment, the final regulations provide that a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold, an easement, or a similar right generally is an interest in real property and thus is real property under section 1031.

H. Requested clarifications regarding easements and leaseholds

Proposed §1.1031(a)-3(a)(5)(ii) provides that a "license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold or easement generally is an interest in real property."

One commenter requested that final §1.1031(a)-3(a)(5)(ii) add the word "perpetual" or "permanent" before "easement" or "communicate that an easement must have a term exceeding 30 years as of the date of the exchange to be consistent with §1.1031(a)-1(c). Under that regulation, examples of exchanges of real property of a like kind include an exchange of a leasehold interest in a fee with a term of 30 years or more to run for real estate.

On this aspect of easements and leaseholds, however, the comments received were not uniform. For example, another commenter requested that final §1.1031(a)-3(a)(5)(ii) specify that leaseholds or easements of any duration are an interest in real property under section 1031. As a conforming revision, the commenter also recommended that the final regulations remove the reference in §1.1031(a)-1(c) to leaseholds with 30 years or more to run to provide parity among all interests in real property eligible for like-kind exchanges under section 1031. In addition, a separate commenter recommended that the final regulations clarify whether a leasehold interest in real property must have, as of the date of the exchange, a remaining term of at least 30 years or more in order to qualify as an interest in real property.

The Treasury Department and the IRS note, as an initial matter, that the proposed and final regulations address solely the qualification of an asset as real property for section 1031 purposes, and do not specifically address whether an exchange is like kind. Duration of an easement or a leasehold is not relevant in determining whether the easement or leasehold is real property under §1.1031(a)-3(a)(5), and therefore, proposed §1.1031(a)-3(a)(5)(ii) did not include a reference to duration. The commenters, however, correctly note that duration may be relevant under §1.1031(a)-1(c) for purposes of determining whether an exchange of an easement or leasehold for real property would qualify as like kind. Because like-kind determinations exceed the scope of the final regulations, the commenters' suggestions and requests for clarification regarding like-kind determinations are not incorporated into these final regulations.

I. Applicability of distinct asset test to three-property rule in §1.1031(k)-1(c)(4)(i)(A)

The proposed regulations provide that, in general, each distinct asset is analyzed separately from each other distinct asset in determining whether a distinct asset is real property for section 1031 purposes. One commenter requested that the final regulations clarify that this distinct asset rule does not apply for purposes of §1.1031(k)-1(c)(4)(i)(A), which generally limits a taxpayer to the identification of three replacement properties (three-property rule). In response to the comment, the Treasury Department and the IRS have added language to the definition of distinct asset in §1.1031(a)-3(a)(4) to clarify that the distinct asset rule applies only for purposes of determining whether property is real property for section 1031 purposes and does not affect the application of the three-property rule.

III. Incidental Property Rule

A. Approach of the proposed regulations

Section 1.1031(k)-1(g)(7)(iii) of the proposed regulations addresses the receipt of personal property that is incidental to the taxpayer's replacement real property in an exchange (incidental property rule). The incidental property rule provides that, for exchanges involving a qualified intermediary, personal property that is incidental to replacement real property (incidental personal property) is disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property held by the qualified intermediary are expressly limited as provided in §1.1031(k)-1(g)(6). However, as personal property, incidental personal property is non-like-kind property that generally results in gain recognition under section 1031(b) on the exchange.

Personal property is incidental to real property acquired in an exchange if (i) in standard commercial transactions, the personal property is typically transferred together with the real property, and (ii) the aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15 per-

cent of the aggregate fair market value of the replacement real property (15-percent limitation).

B. Calculation of 15-percent limitation

The Treasury Department and the IRS received several comments recommending a change to the calculation of the amount of incidental property that a taxpayer may acquire and still meet the requirements of the incidental property rule. For example, commenters recommended that the value of incidental property under the final regulations be permitted to equal up to 15 percent of the total fair market value of the replacement real property, as well as the incidental property. For support, these commenters highlighted that their suggested 15-percent calculation is consistent with sections 856(d)(1)(C) and 856(c)(9)(A)(ii) of the Code pertaining to REITs. In addition, a commenter suggested that final §1.1031(k)-1(g)(7)(iii) should permit the aggregate fair market value of the incidental personal property to equal up to 20 percent of the aggregate fair market value of the replacement real property.

The final regulations do not adopt these comments. As explained in part II of the Explanation of Provisions section of the preamble to the proposed regulations, the proposed incidental property rule is "based on the existing rule in §1.1031(k)-1(c)(5), which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property under section 1031(a)(3)(A) and §1.1031(k)-1(c)." 85 FR 35839. In addition, the Treasury Department has determined that a limitation in excess of 15 percent "might induce taxpayers to bundle more personal property with their exchanged property," which "would lead to increased amounts of personal property exchanged with real property under section 1031 and effectively unlock a class of personal property that would no longer be 'incidental' to the real property." 85 FR 35840. Consequently, the Treasury Department and the IRS continue to believe that the proposed 15-percent limitation, and its calculation, are "responsive to ordinary-course exchanges that often commingle personal property and real property as part of the aggregate exchanged property." *Id.*

C. Requests to identify incidental property rule as a safe harbor

Commenters requested that the incidental property rule be specifically identified in the final regulations as a safe harbor. One commenter expressed concern that, unless identified as a safe harbor, the incidental property rule may be interpreted as a bright-line rule under which acquisitions of personal property valued in excess of 15 percent of the real property will cause the exchange to fail, and the transfer of relinquished property to be fully taxable. Additionally, a separate commenter requested that the final regulations clarify that incidental property may include intangible property such as goodwill.

The final regulations do not adopt the request that the incidental property rule be identified as a safe harbor. The items in current §1.1031(k)-1(g)(1) through (5) consist of safe harbors that help taxpayers comply with other rules in §1.1031(k)-1, and §1.1031(k)-1(g)(7)(i) and (ii) are items that are disregarded in determining whether one of the existing safe harbors ceases to apply. The incidental property rule adds an additional item to §1.1031(k)-1(g)(7) that is disregarded in determining whether one of the existing safe harbors ceases to apply. Identifying the incidental property rule as a safe harbor would thus be confusing because it is an item that is disregarded in determining if an existing safe harbor applies. Therefore, the incidental property rule operates as part of an existing safe harbor. Consequently, acquisitions of personal property valued in excess of 15 percent of the replacement real property are not disregarded in determining if one of the safe harbors in §1.1031(k)-1(g)(3) through (5) ceases to apply and whether the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property are expressly limited as provided in §1.1031(k)-1(g)(6), but will not automatically cause the exchange to fail section 1031 and the transfer of relinquished property to be treated as a sale or taxable exchange.

Further, the incidental property rule applies to non-real property, regardless of whether tangible or intangible. No change to the regulations is required to accommodate this suggestion.

D. Application of section 1031(b) to receipt of incidental personal property

Several commenters recommended that the final incidental property rule provide that a taxpayer's receipt of personal property incidental to the real property received in a like-kind exchange be treated as the receipt of real property, and thus not give rise to recognized gain under section 1031(b). Under section 1031(b), a taxpayer must recognize gain on a section 1031 exchange to the extent of money or non-like-kind property the taxpayer receives in the exchange. Similarly, one commenter suggested that, if the final regulations require recognition of gain on the receipt of incidental personal property, the final regulations should not include the incidental property rule. That commenter contended that inclusion of the incidental property rule in the final regulations will result in some taxpayers misinterpreting the rule by treating incidental personal property in the same manner as real property for purposes of the nonrecognition of gain or loss under section 1031.

The final regulations do not adopt the commenters' recommendations. As amended by the TCJA, section 1031(a) is limited to exchanges of real property. However, the TCJA did not amend section 1031(b), which provides that a taxpayer must recognize gain on an exchange to the extent of money and non-like-kind property received in the exchange. Personal property received in a like-kind exchange of real property is non-like-kind property received in the exchange. Consequently, under section 1031(b), gain generally must be recognized to the extent of the personal property received in the exchange.

The final regulations revise proposed §1.1031(k)-1(g)(7)(iii)(B) slightly to improve readability; the revision does not change the meaning of proposed §1.1031(k)-1(g)(7)(iii)(B).

The final regulations include the incidental property rule to provide assurance to taxpayers that a qualified intermediary's use of exchange proceeds to acquire incidental personal property will not cause the taxpayer to fail to meet the requirements of §1.1031(k)-1(g)(6)(i), and thus the requirements of section 1031. As explained in the preamble to the proposed regulations, the incidental

property rule was proposed to respond to concerns that a taxpayer would be considered to be in constructive receipt of all of the exchange funds held by the qualified intermediary if the taxpayer is able to direct the qualified intermediary to use those funds to acquire property that is not of a like kind to the taxpayer's relinquished property. See generally part II of the Explanation of Provisions section in the preamble to the proposed regulations. The incidental property rule is intended to help taxpayers comply with the requirements of section 1031, particularly the prohibition on a taxpayer's ability to actually or constructively receive the proceeds from the transfer of relinquished property before receiving like-kind replacement property.

One commenter recommended that the final regulations include language specifically providing that the receipt of incidental personal property in a section 1031 exchange results in taxable gain to the taxpayer. The final regulations adopt this recommendation and add language in §1.1031(k)-1(g)(7)(iii) to clarify this point.

E. Request that 15-percent limitation not be applied on a property-by-property basis

One commenter recommended that the final regulations clarify that the 15-percent limitation for the incidental property rule is not applied on a property-by-property basis. For example, assume a taxpayer acquires an office building (Building 1) with office furniture, and a second office building (Building 2) with no personal property. The commenter requested that the final regulations confirm that the taxpayer does not exceed the 15-percent limitation if the value of the furniture is 15 percent or less of the total value of Building 1 and Building 2, even if the value of the furniture exceeds 15 percent of the value of just Building 1.

The Treasury Department and the IRS agree with the commenter's recommendation. Accordingly, the final regulations include language to clarify that the 15-percent limitation is calculated by comparing the value of all of the incidental properties to the value of all of the replacement real properties acquired in the same exchange.

F. Suggested language changes to incidental property rule

One commenter recommended a series of language modifications to the incidental property rule in the proposed §1.1031(k)-1(g)(7)(iii). For example, the commenter recommended that the rule for determining whether personal property is incidental to real property acquired in an exchange not reference the term "commercial transaction." For support, the commenter asserted that the term might be interpreted to include only contracts involving transfers of non-residential property such as commercial real estate and not residential rental property. In addition, the commenter suggested that, in the final regulations, the language "the personal property is typically transferred together with the real property" be replaced with "the personal property is typically listed in the contract and transferred with the real property."

The final regulations do not adopt these suggested modifications because the Treasury Department and the IRS have determined that proposed §1.1031(k)-1(g)(7)(iii) provides clear guidance for determining whether personal property is incidental to real property acquired in an exchange. In particular, the term "commercial transactions" refers to transactions involving business or investment property rather than personal-use property. Accordingly, the term "commercial" describes the type of transaction, not the type of property. Therefore, a commercial transaction may involve either residential or non-residential property.

The final regulations also do not adopt the commenter's recommendation that the language "the personal property is typically transferred together with the real property" be replaced with "the personal property is typically listed in the contract and transferred with the real property." Generally, if personal property is transferred as part of a transfer of real property, the personal property would be listed in the contract relating to the transfer. However, if a taxpayer lists the personal property in a contract separate from the contract addressing the transfer of real property, listing the personal property in a separate contract generally will not prevent the taxpayer from using the incidental property rule.

G. Request to apply incidental property rule retroactively

A commenter also requested that, under the final regulations, the incidental property rule apply retroactively to exchanges after either (i) the 1984 enactment of the deferred exchange rules in section 1031(a)(3) or (ii) the 1991 effective date of the §1.1031(k)-1 deferred exchange final regulations. The commenter observed that the concerns that led to the inclusion of the incidental property rule in the proposed regulations, which include directing a qualified intermediary to use exchange proceeds to acquire non-like-kind property, also existed for pre-TCJA exchanges under section 1031. Thus, the commenter suggested that the incidental property rule apply to pre-TCJA exchanges.

Prior to enactment of the TCJA, personal property was eligible for like-kind exchange treatment. Therefore, a rule disregarding the receipt of incidental personal property in determining whether a taxpayer was in constructive receipt of non-like-kind property prior to enactment of the TCJA would function in a very different way than it does post-TCJA. Accordingly, these final regulations do not adopt this suggestion.

H. Requested clarifications regarding receipt of personal property or escrow funds

Commenters requested clarification regarding the application of the incidental property rule to cash placed in escrow to pay transactional and other items in a real estate transfer. The Treasury Department and the IRS note that a taxpayer's receipt of escrowed funds that the taxpayer placed in escrow for transactional-type items is not a receipt of incidental personal property. Therefore, the final regulations do not revise the incidental property rule in response to the commenters' request. A commenter also requested guidance regarding situations in which an exchanging taxpayer acquires a substantial amount of personal property due to unforeseen circumstances. The final regulations do not address this specific situation. The 15-percent limitation is not a bright-line test for determining whether a transaction fails to meet the requirements of an exchange un-

der section 1031. All of the facts and circumstances of the taxpayer's situation are considered in determining if the exchange meets the requirements of section 1031.

IV. Comments That Exceed the Scope of the Final Regulations

A. Application of section 453 of the Code to gain on a transfer of personal property

A commenter recommended that the final regulations provide clarification regarding the application of section 453 to certain like-kind exchanges. Specifically, the commenter requested guidance about the timing of gain recognition when (i) real property is exchanged for both like-kind real property and non-like-kind personal property incidental to the real property, and (ii) the exchange is not completed until the taxable year succeeding the taxable year of the transfer of the relinquished property. The commenter requested that the final regulations address whether the gain on the receipt of the personal property is recognized in the first or the second taxable year (Tax Year 1 and Tax Year 2, respectively) if the like-kind exchange straddles two taxable years.

The commenter also requested guidance regarding a situation involving a taxpayer who (i) has a *bona fide* intent to execute a section 1031 exchange, (ii) transfers relinquished real property and incidental personal property in Tax Year 1, and (iii) fails to acquire replacement property by the 180th day after the transfer of the relinquished property, which is in Tax Year 2. Specifically, the commenter recommends that the final regulations address whether the gain on the transfer of the personal property is recognized in Tax Year 1 or Tax Year 2.

The Treasury Department and the IRS appreciate the commenter's questions but have determined the commenter's requested guidance exceeds the scope of the final regulations. The issues raised by the commenter relate to the application of current §1.1031(k)-1(j)(2), which addresses the application of the installment method of accounting in section 453 to like-kind exchanges involving the receipt of non-like-kind property that straddles two taxable years, or that would have straddled two taxable years if successfully completed.

The scope of the final regulations is limited to the definition of real property under section 1031 and to incidental property received in a section 1031 exchange. Accordingly, the final regulations do not address the issues relating to the timing of gain recognition raised by the commenter.

B. Application of current §1.1031(j)-1 to post-TCJA exchanges

Several commenters inquired about the application of current §1.1031(j)-1 to exchanges of multiple properties following the enactment of the TCJA. Section 1.1031(j)-1 provides an exception to the general rule that section 1031 requires a property-by-property comparison for computing the gain recognized and basis of property received in a like-kind exchange. Section 1.1031(j)-1 applies when there is more than one exchange group created, as described in §1.1031(j)-1(b)(2) (i), or, if there is only one exchange group, there is more than one property transferred or received within the exchange group. Under §1.1031(j)-1, the amount of gain recognized and the basis of the properties received by a taxpayer are computed after separating the properties transferred and received by the taxpayer in the exchange into exchange groups, in accordance with the rules in §1.1031(j)-1(b)(3) and (c), respectively. In addition, under §1.1031(j)-1(b)(2)(ii), all liabilities assumed by a taxpayer as part of an exchange to which §1.1031(j)-1 applies are offset against all liabilities of which the taxpayer is relieved as part of the exchange.

One commenter asked whether §1.1031(j)-1 applies to a post-TCJA exchange of real property and personal property for other real property and personal property. Under section 1031 as in effect before the TCJA amendments, §1.1031(j)-1 would have applied to this exchange if the relinquished real property was of a like kind to the replacement real property, and the relinquished personal property was of a like kind to the replacement personal property. Other commenters requested the Treasury Department and the IRS to conclude that §1.1031(j)-1 will continue to apply in this situation so that taxpayers will not have to carry out a property-by-property comparison for computing gain on the exchange.

Another commenter inquired about the application of §1.1031(j)-1 to exchanges of both qualifying real property and non-qualifying property that involve indebtedness encumbering both types of properties. Specifically, the commenter asked whether the full amount of the indebtedness assumed by the taxpayer would offset the full amount of the indebtedness liabilities of which the taxpayer is relieved as part of the exchange, even if a portion of that indebtedness relates to the personal property in the exchange.

The Treasury Department and the IRS appreciate the issues raised by these commenters but note that the application of § 1.1031(j)-1 to transactions to which the TCJA applies exceeds the scope of the final regulations. Therefore, the final regulations do not address these comments. The Treasury Department and the IRS, however, continue to consider potential future guidance on issues relating to §1.1031(j)-1.

C. Application of Revenue Rulings 2003-56 and 2004-86

One commenter suggested that Rev. Rul. 2003-56, 2003-23 I.R.B. 985, likely needs to be modified to address post-TCJA exchanges involving both real and personal property. The commenter also questioned whether Rev. Rul. 2004-86, 2004-33 I.R.B. 191, needs to be updated to address the TCJA changes to section 1031.

Rev. Rul. 2003-56 addresses the consequences under section 752 of the Code and §1.704-2(d) of a section 1031 like-kind exchange that straddles two taxable years and involves relinquished and replacement property subject to a liability. The revenue ruling addresses whether the liabilities are netted and which taxable year the net change in a partner's share of partnership liability is taken into account.

Rev. Rul. 2004-86 addresses whether an interest in a Delaware statutory trust (DST) is treated as an interest in the real property owned by the DST, and whether a taxpayer may exchange real property for an interest in a DST in a transaction that qualifies for nonrecognition of gain under section 1031. The revenue ruling examines the grantor trust rules of sections 671 and 677 of the Code and the entity-classi-

fication rules in section 7701 of the Code and the section 7701 regulations. Rev. Rul. 2004-86 concludes that, under the facts of the ruling, including the DST agreement, the exchange qualifies for nonrecognition under section 1031.

The Treasury Department and the IRS appreciate these helpful comments but have determined that they exceed the scope of the final regulations. That scope is limited to the definition of real property under section 1031 and to incidental property received in a section 1031 exchange. Both Rev. Rul. 2003-56 and Rev. Rul. 2004-86 address other issues related to the application of section 1031.

With regard to Rev. Rul. 2004-86, nothing in the proposed regulations or the TCJA is contrary to the view that a transfer of an interest in a DST, if a grantor trust, is treated as the transfer of the underlying property held by the DST. The Treasury Department and the IRS, however, will continue to review existing guidance concerning section 1031 like-kind exchanges to determine the effect of the TCJA on that guidance.

D. Computation error in examples contained in §1.1031(k)-1(d)(2)

A commenter highlighted that examples in §1.1031(k)-1(d)(2) include a computation error. For example, the sum of \$187,500 and \$87,500 is incorrectly provided as \$250,000. Although, the proposed regulations do not address the rules in §1.1031(k)-1(d)(2), this Treasury decision corrects the scrivener's error identified by the commenter by replacing "\$87,500" with "\$62,500" each place it appears therein.

E. Interaction of bonus depreciation rules with section 1031

One commenter discussed the interaction between the additional first year depreciation deduction rules in section 168 of the Code, commonly referred to as bonus depreciation, and the like-kind exchange rules in section 1031, as amended by the TCJA. The commenter pointed out that there may be an adverse timing difference between (i) when gain is recognized on the transfer of real property that includes the transfer of personal property, and (ii) when a taxpayer is allowed a bonus

depreciation deduction for the acquisition of replacement real property and personal property subject to bonus depreciation. The commenter also asserted that when the 100-percent bonus depreciation rules expire after 2022, the gain associated with a section 1031 exchange involving real estate including personal property will be larger than the gain intended by Congress.

These comments, while helpful, exceed the scope of the final regulations. Accordingly, the final regulations do not include the guidance requested by the commenter. However, the Treasury Department and the IRS will consider the interaction between the bonus depreciation rules under section 168 and the like-kind exchange rules under section 1031.

V. Correction to Preamble of Proposed Regulations Regarding Kind or Class of Property

One commenter noted that the background section of the preamble to the proposed regulations provides the following: "Real property of one kind or class may not, under section 1031, be exchanged for real property of a different kind or class." Proposed regulations, Background, part III. The commenter correctly pointed out that this sentence is inaccurate because distinguishing between properties of a different class is relevant to personal property and whether, under section 1031 prior to enactment of the TCJA, personal properties were of like kind, not whether the properties were real property. Consequently, this sentence is deleted from part III of the Background of the preamble to the final regulations.

Statement of Availability of IRS Documents

The IRS guidance cited in this preamble is published in the Internal Revenue Bulletin (or Cumulative Bulletin) and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

Effective/Applicability Date

These final regulations apply to exchanges beginning after December 2,

2020. A taxpayer may rely on the proposed regulations (REG-117589-18) published in the **Federal Register** on June 12, 2020 (85 FR 35835), if followed consistently and in their entirety, for exchanges of real property beginning after December 31, 2017, and before December 2, 2020.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866, 13563, and 13771 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including (i) potential economic, environmental, and public health and safety effects, (ii) potential distributive impacts, and (iii) equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

These regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs (OIRA) has designated these final regulations as economically significant under section 1(c) of the MOA. Accordingly, the OMB has reviewed these final regulations.

A. Background

1. Like-Kind Exchange

Prior to the amendment of section 1031 by the TCJA, certain exchanges of personal, intangible, or real property held for use in a trade or business or for investment qualified for nonrecognition under section 1031. Section 13303 of the TCJA generally limits the application of like-kind exchange treatment to exchanges of real property after December 31, 2017, subject to a transition rule applicable to exchanges not completed by January 1, 2018. Specifically, section 1031 provides that no gain or loss is recognized on the exchange

of real property held for productive use in a trade or business or for investment if the real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment.

2. Final Regulations

The final rules provide a definition of real property to distinguish it from personal property, as the TCJA limited the nonrecognition of gain or loss in the case of like-kind exchanges to exchanges of real property. The legislative history to the TCJA provides that real property eligible for like-kind exchange treatment prior to the TCJA should continue to be eligible for like-kind exchange treatment. Conference Report, at 396, fn. 726. On June 12, 2020, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-117589-18) in the Federal Register (85 FR 35835) containing proposed regulations under section 1031 (proposed regulations). The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. In particular, the final regulations revise the definition of “real property” in the proposed regulations to provide that property is classified as real property for section 1031 purposes if, on the date it is transferred in an exchange, the property is real property under the law of the State or local jurisdiction in which that property is located. However, property ineligible for like-kind exchange treatment before enactment of the TCJA remains ineligible for like-kind exchange treatment after the enactment of the TCJA regardless of its classification under the laws of the State or local jurisdiction. The final regulations also revise the proposed definition of real property to eliminate, with regard to both tangible and intangible properties, any consideration of whether the particular property contributes to the production of income unrelated to the use or occupancy of space (referred to as the “purpose or use test,” as defined in part II.B.1 of this Summary of Comments and Explanation of Revisions).

The final regulations retain the rule relating to personal property in an exchange that is incidental to the real property exchange. Under this rule personal property

is incidental to real property acquired in an exchange if, in standard commercial transactions, the personal property is typically transferred together with the real property, and the aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property. This incidental property rule in the proposed regulations is based on an existing rule in the regulations under section 1031, which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property.

3. No-action Baseline

In this analysis, the Treasury Department and the IRS assess the benefits and costs of these final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these final regulations.

4. Economic Analysis of Final Regulations

The statutory changes made by the TCJA to section 1031 limit like-kind exchanges to real property. The final regulations provide that property is real property for purposes of section 1031 if, on the date it is transferred in an exchange, that property is classified as real property under the law of the State or local jurisdiction in which that property is located. Consequently, under the final regulations, property is classified as real property for purposes of section 1031 if the property is (i) so classified under the State and local law test, (ii) specifically listed as real property in the final regulations, or (iii) considered real property based on all the facts and circumstances under the various factors provided in the final regulations. The proposed regulations had extracted certain portions of the definition of real property from various existing regulations with the intention that they are consistent with the legislative history underlying the TCJA amendment to section 1031. *See, for example*, §§1.263(a)-3(b)(3) and 1.856-10 (defining the term “real property” to mean land and improvements to land such as buildings and other inherently perma-

ment structures, and their structural components); §1.263A-8(c) (providing that real property includes unsevered natural products of land such as growing crops and plants, mines, wells, and other natural deposits); and §1.856-10(c) (providing, in relevant part, that the term “land” includes “water and air space superjacent to land”).

The final regulations also eliminate the purpose or use test for tangible property to qualify as real property that was included in the proposed regulations. If tangible property is permanently affixed to real property and will ordinarily remain affixed for an indefinite period of time, the property is an inherently permanent structure and thus real property for section 1031 purposes, irrespective of the purpose or use of the property or whether it contributes to the production of income.

As emphasized in comments received by the Treasury Department and the IRS, the proposed regulations may have caused certain real property that qualified for like-kind exchange treatment prior to the enactment of the TCJA to no longer qualify. The final regulations more closely follow the legislative history to the TCJA amendments to section 1031. *See* Conference Report, at 396, fn. 726 (providing that Congress “intended that real property eligible for like-kind exchange treatment under present law will continue to be eligible for like-kind exchange treatment under the [amended] provision”). The Treasury Department and the IRS have determined that using the local law test and eliminating the purpose or use test will reduce compliance costs relative to the proposed rules. As a result, taxpayers may rely on existing State and local law definitions of real property or may look to the specifically listed property or the various factors provided in the final regulations.

The Treasury Department and the IRS have determined that there is not likely to be a material difference in the quantity of tangible property that qualifies as real property eligible for like-kind exchanges under the two standards. In making this determination, the Treasury Department and the IRS observed that, for an exchange to qualify for gain-deferral treatment under section 1031, the subject property (that is, the relinquished property) not only must constitute “real property,” but also must be “like kind” with regard to the

property exchanged therefore (that is, the replacement property). Like-kind determinations are made pursuant to Federal, rather than State or local, tax law. *See* generally §1.1031(a)-1(b) through (d). Consequently, State and local law definitions of real property, on their own, affect only one prong of the section 1031 qualification for exchanges of property as a result of these final regulations. In the future, State and local governments could modify their tax laws to include additional assets within the definition of real property. However, the Treasury Department and the IRS cannot determine the extent to which State and local governments may take such actions. The Treasury Department and the IRS note that such actions likely would affect the tax revenue of those jurisdictions.

Moreover, the final regulations provide that property ineligible for like-kind exchange treatment prior to enactment of the TCJA remains ineligible, including real property that was excluded from the application of section 1031. This approach is consistent with Congressional intent that “real property eligible for like-kind exchange treatment” under the law in effect prior to enactment of the TCJA will continue to be eligible for like-kind exchange treatment after enactment of the TCJA. *See* Conference Report at 396, fn. 726. Prior to amendment by the TCJA, former section 1031(a)(2) explicitly excluded certain assets from the application of section 1031. Accordingly, the final regulations exclude from the definition of real property the intangible assets listed in section 1031(a)(2) prior to its amendment by the TCJA, regardless of the classification of the property under State or local law, because such property never was “real property eligible for like-kind exchange treatment” prior to enactment of the TCJA. Conference Report at 396, fn. 726. The final regulations may influence which intangible assets qualify as real property for like-kind exchanges relative to the definition in the proposed regulations. To the extent an intangible asset derives its value from real property or an interest in real property, it is inseparable from that real property or interest in real property. Accordingly, the intangible asset does not produce or contribute to the production of income other than consideration for the use or occupancy of space, and therefore

may be real property or an interest in real property under State or local law. Under the proposed regulations, intangible assets, such as mineral extraction rights or timber cutting rights, that produce income other than for the use or occupancy of space would not be considered real property. Under the final regulations, the mineral rights and timber cutting rights are real property if they are considered real property under State or local law.

The modification of the definition of real property in the final regulations aligns the proposed definition to more closely track the intent of Congress as described in the Conference Report. The proposed rules could have had a significant impact on the amount of intangible property that previously qualified for like-kind exchanges. For example, oil and gas firms accounted for approximately \$4 billion in deferred gains in 2012. This figure can be viewed as an upper limit on the size of the taxable income that the proposed rule could have excluded from qualifying for like-kind exchanges as it includes both developed fields that would have qualified under the proposed rule and mineral rights that may have been excluded. The proposed rule may have also affected other intangible real property such as mineral rights not associated with oil and gas properties or timber cutting rights, but these are likely small when compared to the deferred gains in the oil and gas industry.

Consistent with longstanding regulations under section 1031, in determining whether a taxpayer has actual or constructive receipt of money or other property held by a qualified intermediary, the final regulations disregard certain incidental personal property. Specifically, the final regulations disregard incidental personal property that (1) in standard commercial transactions is typically transferred together with the real property, and (2) does not exceed 15 percent of the aggregate fair market value of the replacement real property. Nonetheless, under section 1031(b), a taxpayer must recognize gain on the receipt of the incidental personal property, which is not like-kind to real property. The 15-percent limitation is responsive to ordinary-course exchanges that often commingle personal property and real property as part of the aggregate exchanged property.

With regard to a limitation on the value of incidental personal property in excess of 15 percent, the Treasury Department and the IRS have determined that a higher limit might induce taxpayers to bundle more personal property with their exchanged property. Such a result would lead to increased amounts of personal property exchanged with real property under section 1031 and effectively unlock a class of personal property that would no longer be “incidental” to the real property. With regard to a lower limit, the Treasury Department and the IRS have determined that the burden of accurately measuring the separate costs of comingled personal and real property would increase.

In addition, the final 15 percent incidental personal property limitation would reduce the cost of investing in real property, when compared to no exchanges for incidental personal property. Raising this limit, however, would further increase the tax incentives for investing in such property, although most taxpayers will be indifferent when exchanging incidental property, plants, and equipment with a depreciable life of 20 years or less that is eligible for 100 percent additional first year depreciation, commonly referred to as “bonus depreciation.” Under 100 percent bonus depreciation, gains from the sale of property can be offset by deductions for investment in other qualifying property. Qualifying property placed in service after September 27, 2017, and before January 1, 2023, qualifies for full bonus depreciation. The bonus depreciation rate is phased down 20 percent a year for property placed in service after this date. In the absence of 100 percent bonus depreciation, expanding incentives for like-kind exchanges through a higher incidental personal property limitation could also distort investment decisions within and across industries leading to over-investment in like-kind properties relative to consistent treatment across properties.

As part of the economic analysis of the proposed regulations, the Treasury Department and the IRS requested comments and information that would help further inform the analysis underlying the proposed 15-percent limitation for incidental personal property. See part I.A.4 of the Special Analyses of the proposed regula-

tions (85 FR 35840). No comments were received by the Treasury Department or the IRS.

The Treasury Department and the IRS have determined that these final regulations will not have meaningful effects regarding the section 1031 qualification of real property exchanges. Finally, these final regulations do not significantly affect compliance burdens as the regulations are substantially similar to existing regulations affecting like-kind exchanges for real property.

II. Paperwork Reduction Act

The collection of information in these final regulations is reflected in the collection of information for Form 8824, Like-Kind Exchanges, which has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number 1545-0074. The number of respondents to Form 8824 for tax year 2018 is estimated at 125,000–220,000. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for taxpayers who file Form 8824, which has not changed as a result of these final regulations, is shown below.

Recordkeeping	10 hr., 16 min.
Learning about the law or the form	1 hr., 59 min.
Preparing the form	2 hr., 14 min.

Form 8824 is used by taxpayers engaging in section 1031 like-kind exchanges. Beginning after December 31, 2017, section 1031 like-kind exchange treatment applies only to exchanges of real property held for use in a trade or business or for investment, other than real property held primarily for sale. Before the law change, section 1031 also applied to certain exchanges of personal or intangible property. These final regulations provide a definition of real property for purposes of section 1031 and a rule

for the receipt of personal property that is incidental to real property received in an exchange and makes conforming changes to the regulations. The law change reflected in the final regulations will result in fewer taxpayers engaging in section 1031 like-kind exchanges. This decrease in burden will be reflected in the updated burden estimates for the Form 8824. The requirement to maintain records to substantiate information on the Form 8824 is already contained in the burden associated with the control number for the form and remains unchanged. For purposes of the Paperwork Reduction Act, no burden estimates specific to the final regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information collections, related to the requirements under the final regulations. Those estimates would capture both changes made by the TCJA and those that arise out of discretionary authority exercised in the final regulations.

The current status of the Paperwork Reduction Act submissions related to section 1031 is provided in the following table. The section 1031 provisions are included in aggregated burden estimates for OMB control number 1545-0074, which represents a total estimated burden time, including all related forms and schedules, of 1.784 billion hours and total estimated monetized costs of \$31.764 billion (\$2017). The burden estimates provided in the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the OMB control number and will in the future include but not isolate the estimated burden of only the section 1031 requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against over-counting the burden that tax provisions imposed prior to the TCJA. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the final regulations. In addition, when available, drafts of IRS forms are posted for comment at www.irs.gov/draftforms.

Form 8824	Individual (NEW Model) 1545-0074	Sixty-day notice published in the Federal Register on 10/30/20 (85 FR 68956). Public Comment period closes on 12/29/20.
Link: https://www.federalregister.gov/documents/2020/10/30/2020-24139/proposed-extension-of-information-collection-request-submitted-for-public-comment-comment-request		

Form 8824 is also used by members of the executive branch of the Federal Government and judicial officers of the Federal Government to elect to defer gain under section 1043 on certain sales of property due to potential conflicts of interest arising from their status as government officials. These final regulations do not address or affect the deferral of gain on sales under section 1043.

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

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

III. *Regulatory Flexibility Act*

It is hereby certified that these final 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).

These final regulations update existing regulations under section 1031 to reflect statutory changes made to section 1031 by the TCJA. Section 1031 provides that a taxpayer exchanging investment property or property held for productive use in a trade or business for other investment or trade or business property recognizes gain only to the extent of money or non-like-kind property received in the exchange, and recognizes no loss on the exchange. Under the TCJA amendments to section 1031, for years after 2017, section 1031 applies only to exchanges of real property and no longer applies to exchanges of personal property and certain intangible property. The final regulations provide a definition of real property to be used in determining whether a taxpayer has met the

requirements of section 1031. In so doing, the final regulations follow the legislative history underlying the TCJA amendment to section 1031 providing that real property eligible for like-kind exchange treatment under pre-TCJA law continues to be eligible for like-kind exchange treatment in years beginning after 2017.

Consequently, the final regulations use a State or local law test and certain aspects from existing regulatory definitions of real property in a manner consistent with the legislative history underlying the TCJA amendment to section 1031 requiring that the definition of real property remain the same both before and after enactment of the TCJA. Taxpayers already are familiar with these rules, which provide that real property includes land, improvements to land, unsevered natural products of land, and water and air space superjacent to land. In addition, the final regulations provide a rule addressing a taxpayer's receipt of personal property that is incidental to the real property the taxpayer receives in the exchange that is based on an existing rule in §1.1031(k)-1.

Individuals and business entities that own investment real property or real property held for productive use in a trade or business may engage in a section 1031 exchange. The provisions of section 1031 apply in the same manner to all taxpayers, so the effect of the final regulations is the same for taxpayers that are small entities and taxpayers that are not small entities. The small entities potentially impacted by these regulations are businesses organized as corporations (including S corporations), partnerships, and individuals that file a Form 1040 Schedule C for their respective trades or businesses or Form 1040 Schedule E for their rental real estate.

The number of small entities potentially affected by these final regulations is unknown but likely substantial because like-kind exchanges are entered into by entities of all sizes. Although a substantial number of small entities is potentially affected by these final regulations, the

Treasury Department and the IRS have concluded that the final regulations will not have a significant economic impact on a substantial number of small entities because the costs to comply with these final regulations are not significant. This is because for taxpayers still able to engage in section 1031 exchanges, there are no additional forms they are required to file, and there is no new recordkeeping required, to comply with section 1031 as amended by the TCJA and these final regulations other than the time to read and understand these regulations. Thus, taxpayers that engage in like-kind exchanges of real property in 2018 and later years will not have any additional burden as compared to taxpayers engaging in like-kind exchanges in years before 2018. Accordingly, the Secretary certifies that these final regulations will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f), the notice of proposed rulemaking preceding this final regulation was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business (85 FR 35835). No comments on the notice were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

IV. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. In 2020, that threshold is approximately \$156 million. This rule does not include any mandate that may result in expenditures by State, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This rule does not have federalism implications and does not impose substantial, direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

VI. Congressional Review Act

The Administrator of OIRA has determined that this Treasury decision is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 et seq.) (CRA). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the Federal Register.

Notwithstanding this requirement, section 808(2) of the CRA allows agencies to dispense with the requirements of section 801 when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and the rule shall take effect at such time as the agency promulgating the rule determines. Pursuant to section 808(2) of the CRA, the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest.

Following the amendments to section 1031 by the TCJA, the Treasury Department and the IRS published the proposed regulations to provide certainty to taxpayers. In particular, and as emphasized by the wide variety of public comments received in response to the proposed regulations, taxpayers lacked certainty regarding the longstanding role of State and local law in real property determinations for purposes of qualification under section 1031. Consistent with Executive Order 13924 (May 19, 2020), the Treasury Department and the IRS have determined that an expedited effective date of the final regulations would “give

businesses, especially small businesses, the confidence they need to re-open by providing guidance on what the law requires.” 85 FR 31353-4. Accordingly, the Treasury Department and the IRS have determined that the rules in this Treasury decision shall take effect on the date of publication in the Federal Register.

Drafting Information

The principal authors of these regulations are Edward C. Schwartz and Suzanne R. Sinno of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

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 1.168(i)-1 is amended by:

1. In the last sentence in paragraph (e)(2)(viii)(A), removing “does not apply.” at the end of the sentence and adding “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in its place;

2. In the first sentence in paragraph (m)(1), removing the word “This” at the beginning of the sentence and adding “Except as provided in paragraph (m)(5) of this section, this” in its place; and

3. Redesignating paragraph (m)(5) as paragraph (m)(6) and adding new paragraph (m)(5).

The addition reads as follows:

§1.168(i)-1 *General asset accounts.*

* * * * *

(m) * * *

(5) *Application of paragraph (e)(2)(viii)(A).* The language “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in the last sentence of paragraph (e)(2)(viii)(A) of this section applies on or after December 2, 2020. Paragraph (e)(2)(viii)(A) of this section as contained in 26 CFR part 1 edition revised as of April 1, 2020, applies before December 2, 2020.

Par. 3. Section 1.168(i)-8 is amended by:

1. In the last sentence in paragraph (c)(4)(i), removing “does not apply” at the end of the sentence and adding “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply” in its place;

2. At the beginning of paragraph (j)(1), removing the word “This” and adding “Except as provided in paragraph (j)(5) of this section, this” in its place;

3. Redesignating paragraph (j)(5) as paragraph (j)(6) and adding new paragraph (j)(5).

The addition reads as follows:

§1.168(i)-8 *Dispositions of MACRS property.*

* * * * *

(j) * * *

(5) *Application of paragraph (c)(4)(i).* The language “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in the last sentence of paragraph (c)(4)(i) of this section applies on or after December 2, 2020. Paragraph (c)(4)(i) of this section as contained in 26 CFR part 1 edition revised as of April 1, 2020, applies before December 2, 2020.

Par. 4. Section 1.1031-0 is amended by revising the entry for §1.1031(a)-1(e) and adding entries for §1.1031(a)-3 to read as follows:

§1.1031-0 *Table of contents.*

* * * * *

§1.1031(a)-1 *Property held for productive use in a trade or business or for investment.*

* * * * *

(e) *Applicability dates.*

* * * * *

§1.1031(a)-3 Definition of real property.

- (a) Real property.
- (b) Examples.
- (c) Applicability date.

* * * * *

Par. 5. Section 1.1031(a)-1 is amended by adding paragraph (a)(3) and revising paragraph (e) to read as follows:

§1.1031(a)-1 Property held for productive use in trade or business or for investment.

(a) * * *

(3) *Exchanges after 2017.* Pursuant to section 13303 of Public Law 115-97 (131 Stat. 2054), for exchanges beginning after December 31, 2017, section 1031 and §§1.1031(a)-1, 1.1031(b)-2, 1.1031(d)-1T, 1.1031(d)-2, 1.1031(j)-1, 1.1031(k)-1, and references to section 1031 in §§1.1031(b)-1, 1.1031(c)-1, and 1.1031(d)-1, apply only to qualifying exchanges of real property (within the meaning of §1.1031(a)-3) that is held for productive use in a trade or business, or for investment, and that is not held primarily for sale.

* * * * *

(e) *Applicability dates*—(1) *Exchanges of partnership interests.* The provisions of paragraph (a)(1) of this section relating to exchanges of partnership interests apply to transfers of property made by taxpayers on or after April 25, 1991.

(2) *Exchanges after 2017.* The provisions of paragraph (a)(3) of this section apply to exchanges beginning after December 2, 2020.

Par. 6. Section 1.1031(a)-3 is added to read as follows:

§1.1031(a)-3 Definition of real property.

(a) *Real property*—(1) *In general.* The term *real property* under section 1031 and §§1.1031(a)-1 through 1.1031(k)-1 means land and improvements to land, unsevered natural products of land, and water and air space superjacent to land. Under paragraph (a)(5) of this section, an intangible interest in real property of a type described in this paragraph (a)(1) is real property for purposes of section 1031 and this section. Property that is real property under State or local law as provided in paragraph (a)(6) of this sec-

tion is real property for purposes of section 1031 and this section.

(2) *Improvements to land*—(i) *In general.* The term *improvements to land* means inherently permanent structures and the structural components of inherently permanent structures.

(ii) *Inherently permanent structures*—(A) *In general.* The term *inherently permanent structure* means any building or other structure that is a distinct asset within the meaning of paragraph (a)(4) of this section and is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. Affixation is considered permanent if it is reasonably expected to last indefinitely based on all the facts and circumstances.

(B) *Building.* A building is any structure or edifice enclosing a space within its walls, and covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. Buildings include the following distinct assets if permanently affixed: houses, apartments, hotels, motels, enclosed stadiums and arenas, enclosed shopping malls, factories and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores.

(C) *Other inherently permanent structures.* Inherently permanent structures under paragraph (a)(2)(ii) of this section include the following distinct assets, if permanently affixed: in-ground swimming pools; roads; bridges; tunnels; paved parking areas, parking facilities, and other pavements; special foundations; stationary wharves and docks; fences; inherently permanent advertising displays for which an election under section 1033(g)(3) is in effect; inherently permanent outdoor lighting facilities; railroad tracks and signals; telephone poles; power generation and transmission facilities; permanently installed telecommunications cables; microwave transmission, cell, broadcasting, and electric transmission towers; oil and gas pipelines; offshore platforms, derricks, oil and gas storage tanks; and grain storage bins and silos. Affixation to real property may be accomplished by weight alone. If property is not listed as an inherently permanent structure in paragraph (a)(2)(ii)(B) or (C) of this section, the determination of whether the property is an in-

herently permanent structure under paragraph (a)(2)(ii) of this section is based on the following factors—

(1) The manner in which the distinct asset is affixed to real property;

(2) Whether the distinct asset is designed to be removed or to remain in place;

(3) The damage that removal of the distinct asset would cause to the item itself or to the real property to which it is affixed;

(4) Any circumstances that suggest the expected period of affixation is not indefinite; and

(5) The time and expense required to move the distinct asset.

(iii) *Structural components*—(A) *In general.* The term *structural component* means any distinct asset, within the meaning of paragraph (a)(4) of this section, that is a constituent part of, and integrated into, an inherently permanent structure. If interconnected assets work together to serve an inherently permanent structure (for example, systems that provide a building with electricity, heat, or water), the assets are analyzed together as one distinct asset that may be a structural component. A structural component may qualify as real property only if the taxpayer holds its interest in the structural component together with a real property interest in the space in the inherently permanent structure served by the structural component. If a distinct asset is customized, the customization does not affect whether the distinct asset is a structural component. Tenant improvements to a building that are inherently permanent or otherwise classified as real property within the meaning of this paragraph (a)(2)(iii) are real property under this section. However, property produced for sale, such as bricks, nails, paint, and windowpanes, that is not real property in the hands of the producing taxpayer or a related person, as defined in section 1031(f)(3), but that may be incorporated into real property by an unrelated buyer, is not treated as real property by the producing taxpayer.

(B) *Examples of structural components.* Structural components include the following items, provided the item is a constituent part of, and integrated into, an inherently permanent structure: walls; partitions; doors; wiring; plumbing systems; central air conditioning and heating

systems; pipes and ducts; elevators and escalators; floors; ceilings; permanent coverings of walls, floors, and ceilings; insulation; chimneys; fire suppression systems, including sprinkler systems and fire alarms; fire escapes; security systems; humidity control systems; and other similar property. If a component of a building or inherently permanent structure is a distinct asset and is not listed as a structural component in this paragraph (a)(2)(iii)(B), the determination of whether the component is a structural component under this paragraph (a)(2)(iii) is based on the following factors—

(1) The manner, time, and expense of installing and removing the component;

(2) Whether the component is designed to be moved;

(3) The damage that removal of the component would cause to the item itself or to the inherently permanent structure to which it is affixed; and

(4) Whether the component is installed during construction of the inherently permanent structure.

(3) *Unsevered natural products of land.* Unsevered natural products of land, including growing crops, plants, and timber; mines; wells; and other natural deposits, generally are treated as real property for purposes of this section. Natural products and deposits, such as crops, timber, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land.

(4) *Distinct asset—(i) In general.* For this section, a distinct asset is analyzed separately from any other assets to which the asset relates to determine if the asset is real property, whether as land, an inherently permanent structure, or a structural component of an inherently permanent structure. Buildings and other inherently permanent structures are distinct assets. Assets and systems listed as a structural component in paragraph (a)(2)(iii)(B) of this section are treated as distinct assets.

(ii) *Facts and circumstances.* The determination of whether a particular separately identifiable item of property is a distinct asset is based on all the facts and circumstances. In particular, the following factors must be taken into account—

(A) Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset;

(B) Whether the item can be separated from a larger asset, and if so, the cost of separating the item from the larger asset;

(C) Whether the item is commonly viewed as serving a useful function independent of a larger asset of which it is a part; and

(D) Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset.

(5) *Intangible assets—(i) In general.* Intangible assets that are real property for purposes of section 1031 and this section include the following items: fee ownership; co-ownership; a leasehold; an option to acquire real property; an easement; stock in a cooperative housing corporation; shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) of the Code if, at the time of the exchange, such shares have been recognized by the highest court of the State in which the company was organized, or by a State statute, as constituting or representing real property or an interest in real property; and land development rights. Similar interests are real property for purposes of section 1031 and this section if the intangible asset derives its value from real property or an interest in real property and is inseparable from that real property or interest in real property. The following intangible assets are not real property for purposes of section 1031 and this section, regardless of the classification of such property under State or local law—

(A) Stock not described in paragraph (a)(5)(i) of this section, bonds, or notes;

(B) Other securities or evidences of indebtedness or interest;

(C) Interests in a partnership (other than an interest in a partnership that has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K);

(D) Certificates of trust or beneficial interests; and

(E) Choses in action.

(ii) *Licenses and permits.* A license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold, easement, or other similar right, generally is an interest in real property under this section. However, a license or permit to engage in or operate a business on real

property is not real property or an interest in real property, regardless of its classification under State or local law.

(6) *State or local law.* Except as otherwise provided in paragraph (a)(5) of this section, property is real property within the meaning of paragraph (a)(1) of this section under State or local law if, on the date it is transferred in an exchange, the property is real property under the law of the State or local jurisdiction in which that property is located.

(7) *No inference outside of section 1031.* The rules provided in this section concerning the definition of real property apply only for purposes of section 1031. No inference is intended with respect to the classification or characterization of property for other purposes of the Code, such as depreciation and sections 1245 and 1250. For example, a structure or a portion of a structure may be section 1245 property for depreciation purposes and for determining gain under section 1245, notwithstanding that the structure or the portion of the structure is real property under this section. Also, a taxpayer transferring relinquished property that is section 1245 property in a section 1031 exchange is subject to the gain recognition rules under section 1245 and the regulations under section 1245, notwithstanding that the relinquished property or replacement property is real property under this section. In addition, the taxpayer must follow the rules of section 1245 and the regulations under section 1245, and section 1250 and the regulations under section 1250, based on the determination of the relinquished property and replacement property being, in whole or in part, section 1245 property or section 1250 property under those Code sections and not under this section.

(b) *Examples.* The following examples illustrate the provisions of this section. In each example, unless otherwise provided, the State or local law of the applicable jurisdiction in which the property at issue is located does not address whether the property is real property.

(1) *Example 1: Natural products of land.* A owns land with perennial fruit-bearing plants that A harvests annually. The unsevered plants are natural products of the land within the meaning of paragraph (a)(3) of this section and thus are real property for purposes of section 1031. A annually harvests fruit from the plants. Upon severance from the land, the harvested fruit ceases to be part of the land and there-

fore is not real property. Storage of the harvested fruit upon or within real property does not cause the harvested fruit to be real property.

(2) *Example 2: Water space superjacent to land.* B owns a marina comprised of U-shaped boat slips and end ties. The U-shaped boat slips are spaces on the water that are surrounded by a dock on three sides. The end ties are spaces on the water at the end of a slip or on a long, straight dock. B rents the boat slips and end ties to boat owners. The boat slips and end ties are water space superjacent to land and thus are real property within the meaning of paragraph (a)(1) of this section.

(3) *Example 3: Indoor sculpture.* (i) C owns an office building and a large sculpture in the atrium of the building. The sculpture measures 30 feet tall by 18 feet wide and weighs five tons. The building was specifically designed to support the sculpture, which is permanently affixed to the building by supports embedded in the building's foundation. The sculpture was constructed within the building. Removal would be costly and time consuming and would destroy the sculpture. The sculpture is reasonably expected to remain in the building indefinitely.

(ii) The sculpture is not an inherently permanent structure listed in paragraph (a)(2)(ii)(C) of this section, and, therefore, C must use the factors provided in paragraphs (a)(2)(ii)(C)(1) through (5) of this section to determine whether the sculpture is an inherently permanent structure. The sculpture—

(A) Is permanently affixed to the building by supports embedded in the building's foundation;

(B) Is not designed to be removed and is designed to remain in place indefinitely;

(C) Would be damaged if removed and would damage the building to which it is affixed;

(D) Is expected to remain in the building indefinitely; and

(E) Would require significant time and expense to move.

(iii) The factors described in paragraphs (a)(2)(ii)(C)(1) through (5) of this section all support the conclusion that the sculpture is an inherently permanent structure within the meaning of paragraph (a)(2)(ii)(A) of this section. Therefore, the sculpture is real property.

(4) *Example 4: Bus shelters.* (i) D owns 400 bus shelters, each of which consists of four posts, a roof, and panels enclosing two or three sides. D enters into a long-term lease with a local transit authority for use of the bus shelters. Each bus shelter is prefabricated from steel and is bolted to the sidewalk. Bus shelters are disassembled and moved when bus routes change. Moving a bus shelter takes less than a day and does not significantly damage either the bus shelter or the real property to which it was affixed.

(ii) The bus shelters are not permanently affixed enclosed transportation stations or terminals, are not buildings under paragraph (a)(2)(ii)(B) of this section, nor are they listed as types of other inherently permanent structures in paragraph (a)(2)(ii)(C) of this section. Therefore, the bus shelters must be analyzed to determine whether they are inherently permanent structures using the factors provided in paragraphs (a)(2)(ii)(C)(1) through (5) of this section. The bus shelters—

(A) Are not permanently affixed to the land or an inherently permanent structure;

(B) Are designed to be removed and not remain in place indefinitely;

(C) Would not be damaged if removed and would not damage the sidewalks to which they are affixed;

(D) Will not remain affixed indefinitely; and

(E) Would not require significant time and expense to move.

(iii) The factors described in paragraphs (a)(2)(ii)(C)(1) through (5) of this section all support the conclusion that the bus shelters are not inherently permanent structures within the meaning of paragraph (a)(2)(ii) of this section. Thus, the bus shelters are not inherently permanent structures within the meaning of paragraph (a)(2)(ii) of this section and, therefore, are not real property.

(5) *Example 5: Industrial 3D printer and generator.* (i) E owns a building that it uses in its trade or business of manufacturing airplane parts. The building includes an industrial 3D printer that can print airplane wings and an electrical generator that serves the building and the 3D printer in a backup capacity. The 3D printer weighs 12 tons, is designed to remain in place indefinitely once installed in the building, and its removal would be time-consuming and very costly, and would cause significant damage to the building. The 3D printer was installed during the building's construction. The generator also was installed during construction and is designed to remain in place indefinitely once installed. Although costly and time-consuming to remove, removal of the generator will not result in substantial damage to the generator or the building.

(ii) The 3D printer is not listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section. Therefore, the 3D printer must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The 3D printer—

(A) Is time-consuming and costly to move;

(B) Is not designed to be moved;

(C) If removed, would cause significant damage to the building in which it is located; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the 3D printer is a structural component of E's building and real property under this section. Thus, the 3D printer is real property.

(iv) The electrical generator also is not listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section and must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The generator—

(A) Is time-consuming and costly to move;

(B) Is not designed to be moved;

(C) If removed, would not result in significant damage to the generator or the building in which it is located; and

(D) Was installed during construction of the building.

(v) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section, considered in the aggregate, support the conclusion that the generator is a structural component of E's building. Although the generator's removal would not result in signifi-

cant damage to the generator or to E's building, that factor does not outweigh the factors supporting the conclusion that it is a structural component. Consequently, the generator is a structural component of E's building and real property under this section.

(6) *Example 6: Raised flooring for industrial 3D printer.* (i) The facts are the same as in paragraph (b)(5), *Example 5*, except that E, when installing its 3D printer, also installed a raised flooring system for the purpose of facilitating the operation of the 3D printer. The raised flooring system is not designed or constructed to remain permanently in place. Rather, the raised flooring system can be removed, without any substantial damage to the system itself or to the building, and then reused. The raised flooring was installed during the building's construction.

(ii) Although floors are listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section, the raised flooring system installed to facilitate the operation of E's 3D printer is not a constituent part of, and integrated into, an inherently permanent structure as required by paragraph (a)(2)(iii)(A) of this section and, therefore, is not flooring as listed in paragraph (a)(2)(iii)(B) of this section. Thus, the raised flooring must be analyzed to determine whether it is a structural component of E's building (within the meaning of paragraph (a)(2)(iii) of this section) using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The raised flooring—

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section, considered in the aggregate, support the conclusion that the raised flooring is not a structural component of E's building within the meaning of paragraph (a)(2)(iii) of this section. Although the raised flooring was installed during construction of the building, that factor does not outweigh the factors supporting the conclusion that the flooring is not a structural component. Therefore, the raised flooring is not real property.

(7) *Example 7: Steam turbine.* (i) F owns a building with a large steam turbine attached as a fixture to the building. The steam turbine is a component of a system used for the commercial production of electricity for sale to customers in the ordinary course of F's business as an electric utility. The steam turbine also generates electricity for F's building. The steam turbine takes up a substantial portion of the building and is designed to remain in place indefinitely once installed in F's building. The steam turbine was installed during the construction of the building and its removal would be costly and cause damage to the building.

(ii) The steam turbine is not listed as an example of a structural component under paragraph (a)(2)(iii)(B) of this section and must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The steam turbine—

(A) Is costly to remove from the building in which it is located;

(B) Is not designed to be moved;

(C) If removed, would cause damage to the building; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(I) through (4) of this section support the conclusion that the steam turbine is a structural component of F's building and real property under this section. Thus, the steam turbine is real property.

(8) *Example 8: Partitions.* (i) G owns an office building that it leases to tenants. The building includes partitions owned by G that are used to delineate space within the building. The office building has two types of interior, non-load-bearing drywall partition systems: a conventional drywall partition system (Conventional Partition System) and a modular drywall partition system (Modular Partition System). Neither the Conventional Partition System nor the Modular Partition System was installed during construction of the office building. Conventional Partition Systems are comprised of fully integrated gypsum board partitions, studs, joint tape, and covering joint compound. Modular Partition Systems are comprised of assembled panels, studs, tracks, and exposed joints. Both the Conventional Partition System and the Modular Partition System reach from the floor to the ceiling. In addition, both are distinct assets as described in paragraph (a)(4) of this section.

(ii) Depending on the needs of a new tenant, the Conventional Partition System may remain in place when a tenant vacates the premises. The Conventional Partition System is integrated into the office building and is designed and constructed to remain in areas not subject to reconfiguration or expansion. The Conventional Partition System can be removed only by demolition, and, once removed, neither the Conventional Partition System nor its components can be reused. Removal of the Conventional Partition System causes substantial damage to the Conventional Partition System itself, but does not cause substantial damage to the building.

(iii) Modular Partition Systems are typically removed when a tenant vacates the premises. Modular Partition Systems are not designed or constructed to remain permanently in place. Modular Partition Systems are designed and constructed to be movable. Each Modular Partition System can be readily removed, remains in substantially the same condition as before, and can be reused. Removal of a Modular Partition System does not cause any substantial damage to the Modular Partition System itself or to the building. The Modular Partition System may be moved to accommodate the reconfigurations of the interior space within the office building for various tenants that occupy the building.

(iv) The Conventional Partition System is comprised of walls that are integrated into an inherently permanent structure and are listed as structural components in paragraph (a)(2)(iii)(B) of this section. Thus, the Conventional Partition System is real property.

(v) The Modular Partition System is not integrated into the building as required by paragraph (a)(2)(iii)(A) of this section and, therefore, is not listed

in paragraph (a)(2)(iii)(B) of this section. Thus, the Modular Partition System must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(I) through (4) of this section. The Modular Partition System—

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal; and

(D) Was not installed during construction of the building.

(vi) The factors described in paragraphs (a)(2)(iii)(B)(I) through (4) of this section support the conclusion that the Modular Partition System is not a structural component of G's office building within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the Modular Partition System is not real property.

(9) *Example 9: Pipeline transmission system.*

(i) H owns a natural gas pipeline transmission system that provides a conduit to transport natural gas from unrelated third-party producers and gathering facilities to unrelated third-party distributors and end users. The pipeline transmission system is comprised of underground pipelines, isolation valves and vents, pressure control and relief valves, meters, and compressors. Each of these distinct assets was installed during construction of the pipeline transmission system and each was designed to remain permanently in place.

(ii) The pipelines are permanently affixed and are listed as other inherently permanent structures in paragraph (a)(2)(ii)(C) of this section. Thus, the pipelines are real property.

(iii) Isolation valves and vents are placed at regular intervals along the pipelines to isolate and evacuate sections of the pipelines in case there is need for a shut-down or maintenance of the pipelines. Pressure control and relief valves are installed at regular intervals along the pipelines to provide overpressure protection. The isolation valves and vents and pressure control and relief valves are not listed in paragraph (a)(2)(iii)(B) of this section and, therefore, must be analyzed to determine whether they are structural components using the factors provided in paragraphs (a)(2)(iii)(B)(I) through (4) of this section. The isolation valves and vents and pressure control and relief valves—

(A) Are time consuming and expensive to install and remove from the pipelines;

(B) Are designed specifically for the particular pipelines for which they are a part;

(C) Will sustain damage and will damage the pipelines if removed; and

(D) Were installed during construction of the pipelines.

(iv) The factors in paragraphs (a)(2)(iii)(B)(I) through (4) of this section support the conclusion that the isolation valves and vents and pressure control and relief valves are structural components of H's pipelines within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the isolation valves and vents and pressure control and relief valves are real property.

(v) Meters are used to measure the natural gas passing into or out of the pipeline transmission system for purposes of determining the end users' consumption. Over long distances, pressure is lost due to friction in the pipeline transmission system. Compressors are required to add pressure to transport natural gas through the entirety of the pipeline transmission system. H installed meters and compressors during the construction of the pipelines. However, unlike other types of such meters and compressors, these particular meters and compressors are not time consuming and expensive to install and remove from the pipelines; are not designed specifically for the particular pipelines for which they are a part; and their removal does not cause damage to the asset or the pipelines if removed. Therefore, the meters and compressors installed by H are not structural components within the meaning of paragraph (a)(2)(iii) of this section and, therefore, are not real property.

(10) *Example 10: State or local law determination of property.* (i) J owns water pipeline in State X that it wants to exchange for cell phone towers located in State Y. On the date that J transfers the water pipeline in an exchange for the cell phone towers, the water pipeline is classified as real property under the law of State X, the jurisdiction in which the water pipeline is located.

(ii) The water pipeline is real property under paragraphs (a)(1) and (a)(6) of this section, regardless of whether the water pipeline is listed as an inherently permanent structure or a structural component of an inherently permanent structure, or is real property under the factors listed in paragraph (a)(2)(ii)(C) or (a)(2)(iii)(B) of this section.

(iii) Cell phone towers are listed as an inherently permanent structure under paragraph (a)(2)(ii)(C) of this section. Thus, the cell phone towers that J acquires in the exchange for the water pipeline are real property under this section, regardless of the State or local characterization of the cell phone towers or whether the cell phone towers are real property under the factors in paragraph (a)(2)(ii)(C) or (a)(2)(iii)(B) of this section.

(11) *Example 11: Land use permit.* K receives a special use permit from the government to place a cell tower on Federal Government land that abuts a Federal highway. Government regulations provide that the permit is not a lease of the land, but is a permit to use the land for a cell tower. Under the permit, the government reserves the right to cancel the permit and compensate K if the site is needed for a higher public purpose. The permit is in the nature of a leasehold that allows K to place a cell tower in a specific location on government land. Therefore, the permit is an interest in real property under paragraph (a)(5) of this section.

(12) *Example 12: License to operate a business.* L owns a building and receives a license from State A to operate a casino in the building. The license applies only to K's building and cannot be transferred to another location. L's building is an inherently permanent structure under paragraph (a)(2)(ii)(A) of this section and, therefore, is real property. However, L's license to operate a casino is not a right for the use, enjoyment, or occupation of L's building, but is rather a license to engage in or operate the casino business in the building. Therefore, the casino li-

cense is not real property or an interest in real property under paragraph (a)(5)(ii) of this section.

(c) *Applicability date.* This section applies to exchanges beginning after December 2, 2020.

Par. 7. Section 1.1031(k)-1 is amended by:

1. In paragraph (d)(2), removing “\$87,500” and adding in its place “\$62,500” each place it appears;

2. Removing “, and” at the end of paragraph (g)(7)(i) and adding a semicolon in its place;

3. Removing the period at the end of paragraph (g)(7)(ii) and adding “, and” in its place;

4. Adding paragraph (g)(7)(iii);

5. In paragraph (g)(8), designating *Examples 1 through 5* as paragraphs (g)(8)(i) through (v), respectively;

6. In newly designated paragraph (g)(8)(i):

a. Redesignating paragraph (g)(8)(i)(i) as paragraph (g)(8)(i)(A);

b. In newly designated paragraph (g)(8)(i)(A), redesignating paragraphs (g)(8)(i)(A)(A) and (B) as paragraphs (g)(8)(i)(A)(1) and (2), respectively;

c. Designating the undesignated paragraph immediately following newly redesignated paragraph (g)(8)(i)(A)(2) as paragraph (g)(8)(i)(A)(3); and

d. In newly designated paragraph (g)(8)(i) redesignating paragraph (g)(8)(i)(ii) as paragraph (g)(8)(i)(B);

7. In newly designated paragraph (g)(8)(ii):

a. Redesignate old paragraph (i) as paragraph (A);

b. Redesignate old paragraph (A) as paragraph (1);

c. Redesignate old paragraphs (1) and (2) as paragraphs (i) and (ii), respectively;

d. Redesignate old paragraphs (B) and (C) as paragraphs (2) and (3), respectively;

e. Designating the undesignated paragraph immediately following newly redesignated paragraph (g)(8)(ii)(A)(3) as paragraph (g)(8)(ii)(A)(4); and

f. Redesignate old paragraphs (ii) and (iii) as paragraphs (B) and (C), respectively;

8. In newly designated paragraph (g)(8)(iii), redesignating old paragraphs (i) through (v) as paragraphs (A) through (E), respectively;

9. In newly designated paragraph (g)(8)(iv), redesignating old paragraphs (i) through (iii) as paragraphs (A) through (C), respectively;

10. In newly designated paragraph (g)(8)(v), redesignating old paragraphs (i) through (iii) as paragraphs (A) through (C), respectively;

11. Adding paragraph (g)(8)(vi); and

12. Adding paragraph (g)(9).

The additions read as follows:

§1.1031(k)-1 Treatment of deferred exchanges.

* * * * *

(g) * * *

(7) * * *

(iii) Personal property generally resulting in gain recognition under section 1031(b) that is incidental to real property acquired in an exchange. For purposes of this paragraph (g)(7), personal property is incidental to real property acquired in an exchange if—

(A) In standard commercial transactions, the personal property is typically transferred together with the real property; and

(B) The aggregate fair market value of the property described in paragraph (g)(7)(iii)(A) of this section transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property or properties received in the exchange.

* * * * *

(8) * * *

(vi) *Example 6.* (A) In 2020, B transfers to C real property with a fair market value of \$1,100,000 and an adjusted basis of \$400,000. B’s replacement property is an office building and, as a part of the exchange, B also will acquire certain office furniture in the building that is not real property, which is industry practice in a transaction of this type. The fair market value of the real property B will acquire is \$1,000,000 and the fair market value of the personal property is \$100,000.

(B) In a standard commercial transaction, the buyer of an office building typically also acquires some or all of the office furniture in the building. The fair market value of the personal property B will acquire does not exceed 15 percent of the fair market value of the office building B will acquire. Accordingly, under paragraph (g)(7)(iii) of this section, the personal property is incidental to the real property in the exchange and is disregarded in determining whether the taxpayer’s rights to receive, pledge, borrow or otherwise obtain the benefits of money or non-like-kind property are expressly limited as provided in paragraph (g)(6) of this section. Upon the receipt of the personal property, B recognizes gain of \$100,000 under section 1031(b), the lesser of the realized gain on the disposition of the relinquished property, \$700,000, and the fair market value of the non-like-kind property B acquired in the exchange, \$100,000.

(9) *Applicability date.* Paragraphs (g)(7)(iii) and (g)(8)(vi) of this section apply to exchanges beginning after December 2, 2020.

* * * * *

Sunita Lough,
*Deputy Commissioner for Services
and Enforcement.*

Approved: November 18, 2020

David J. Kautter,
*Assistant Secretary of the Treasury
(Tax Policy).*

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

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

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

Abbreviations

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

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

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

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

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2019–27 through 2019–52 is in Internal Revenue Bulletin 2019–52, dated December 27, 2019.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2019–27 through 2019–52 is in Internal Revenue Bulletin 2019–52, dated December 27, 2019.

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