

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

Notice 2023-10, page 403.

This notice provides that calendar year 2022 will be regarded as a transition period for purposes of IRS enforcement and administration of the modified de minimis exception for third party settlement organizations (TPSO) and third party network transactions. With respect to calendar years beginning before January 1, 2023, a TPSO is not required to report payments in settlement of third party network transactions with respect to a participating payee unless the amount to be reported exceeds \$20,000 and the number of such transactions with that participating payee exceeds 200.

EXCISE TAX

Notice 2023-2, page 374.

This notice announces forthcoming proposed regulations addressing the application of the stock repurchase excise tax under section 4501 of the Internal Revenue Code, enacted as part of Public Law 117-169, 136 Stat. 1818 (August 16, 2022), commonly referred to as the Inflation Reduction Act of 2022. This notice describes certain rules and procedures (i) clarifying the application of the excise tax to M&A transactions and corporate liquidations, (ii) dictating when a corporation must take into account "accelerated stock repurchases" of its stock, (iii) addressing compensatory stock awards and stock contributions to employer-sponsored plans, (iv) preventing inappropriate avoidance of the excise tax by certain foreign corporations, and (v) on how to report and pay the excise tax.

INCOME TAX

Announcement 2023-1, page 422.

This announcement notifies taxpayers of the applicable reference standard required to be used to determine

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the amount of the energy efficient commercial building property deduction allowed under § 179D of the Internal Revenue Code, as amended by § 13303 of Public Law 117-169, 136 Stat. 1818, 1947 (August 16, 2022), commonly known as the Inflation Reduction Act of 2022 (IRA). This announcement identifies the existing reference standard, affirms a new reference standard, and clarifies when each of the two reference standards will apply to taxpayers. The effective date of this announcement is January 1, 2023.

Notice 2023-1, page 373.

This notice informs taxpayers that the Department of the Treasury and the Internal Revenue Service (IRS) intend to propose regulations addressing the definitions of certain terms in respect of the credit available under section 30D of the Code, and lays out the expected content of those regulations. The proposed regulations will include definitions of the following terms, which are relevant for new clean vehicles placed in service after December 31, 2022:

1. Final Assembly;
2. North America;
3. Manufacturer's Suggested Retail Price;
4. Classifications for categories of vehicles, including vans, sport utility vehicles, pickup trucks, and other vehicles; and
5. Placed in service.

Notice 2023-3, page 388.

This notice provides the optional 2023 standard mileage rates for taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This notice also provides the amount taxpayers must use in calculating reductions to basis for depreciation taken under the business standard mileage rate, and the

maximum standard automobile cost that may be used in computing the allowance under a fixed and variable rate plan. Additionally, this notice provides the maximum fair market value of employer-provided automobiles first made available to employees for personal use in calendar year 2023 for which employers may use the fleet-average valuation rule in § 1.61-21(d)(5) (v) or the vehicle cents-per-mile valuation rule in § 1.61-21(e).

Notice 2023-7, page 390.

This notice announces the intention of the Department of the Treasury and the Internal Revenue Service to issue proposed regulations addressing the application of the corporate alternate minimum tax (CAMT), as added to the Code by the Inflation Reduction Act of 2022. This notice describes the rules intended to be included in the forthcoming proposed regulations, including rules relating to certain issues regarding subchapters C and K of the Code, troubled corporations, groups of corporations filing a consolidated Federal income tax return, the depreciation of section 168 property, and the treatment of certain Federal income tax credits under the CAMT. The notice also provides a simplified method for determining whether a corporation is an “applicable corporation” subject to the CAMT. Finally, the notice provides a request for comments and the procedure for submitting such comments.

Notice 2023-9, page 402.

This notice informs taxpayers that based on analysis by the Department of Energy of representative qualified commercial clean vehicles and comparable internal combustion engine vehicles, the Department of the Treasury and the Internal Revenue Service (IRS) have reviewed the incremental cost for all vehicles manufactured primarily for use on public streets (street vehicles) in calendar year 2023. This analysis shows that the incremental cost of all street vehicles that have a gross vehicle weight rating of less than 14,000 pounds will be greater than \$7,500 in calendar year 2023. Accordingly, the incremental cost will not limit the available credit amount under § 45W for street vehicles that have a gross vehicle weight rating of less than 14,000 pounds and are placed in service in calendar year 2023. In addition, this analysis provides an incremental cost for several different classes of street vehicles with a gross vehicle weight rating of 14,000 pounds or more in calendar year 2023. The IRS will accept a taxpayer’s reliance on the incremental cost published by the Department of Energy for the appropriate class of street vehicle.

Notice 2023-11, page 404.

The Notice is intended to provide FATCA reporting relief to Model 1 FFIs who have been unable to obtain US TINs for their pre-existing accounts that are US reportable accounts; as part of the relief, the FFIs will also provide information that the IRS can analyze to determine why these TINs are missing. The publication has been coordinated with Treasury and the Service.

REG-100442-22, page 423.

This Notice of Proposed Rule Making contains two parts. The first part concerns section 892, which provides foreign governments a limited exemption from taxation. These proposed regulations provide guidance regarding the treatment of certain foreign government entities, including qualified foreign pension funds, as controlled commercial entities for purposes of section 892. The second part concerns section 897, which generally taxes a foreign person’s gain on the sale of real property located in the United States (“United States Real Property Interest”). A United States Real Property Interest includes interests in certain domestic corporations when a large portion of their assets comprise United States Real Property Interests; however, interests in domestically controlled REITs and certain RICs (Qualified Investment Entities) are not United States Real Property Interests. These proposed regulations describe how to determine when a Qualified Investment Entity is domestically controlled, particularly when the foreign person indirectly owns shares of the underlying Qualified Investment Entity through partnerships or corporations, and when the Qualified Investment Entity’s shares are held by a qualified foreign pension fund.

REG-146537-06, page 436.

The Department of the Treasury and the IRS are reopening the comment period for REG-146537-06, relating to the exemption from taxation afforded to foreign governments under section 892.

Rev. Proc. 2023-8, page 407.

This revenue procedure modifies Rev. Proc. 2022-14, 2022-7 I.R.B. 502, to provide procedures under § 446 of the Internal Revenue Code and § 1.446-1(e) of the Income Tax Regulations to obtain automatic consent of the Commissioner of Internal Revenue to change methods of accounting for specified research or experimental expenditures to comply with § 174 of the Code, as amended by § 13206 of Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act.

Rev. Proc. 2023-10, page 411.

This revenue procedure prescribes the loss payment patterns for the 2022 determination year and the discount factors for the 2022 accident year for use by insurance companies in computing discounted unpaid losses under § 846 of the Internal Revenue Code and discounted estimated salvage recoverable under § 832.

Rev. Proc. 2023-11, page 417.

This revenue procedure modifies and supersedes Rev. Proc. 2023-8. This revenue procedure contains guidance similar to Rev. Proc. 2023-8, but modifies the audit protection terms to make clear that taxpayers do not receive audit protection with respect to the treatment of § 174 expenditures incurred prior to making the change in the method of accounting if the year of change is the year immediately subsequent to the first taxable year in which § 174 becomes effective.

TD 9771, page 346.

Generally, a foreign person is taxed on the gain on the sale of real property located in the United States (“United States Real Property Interests”). In addition, one who purchases a United States Real Property Interest from a foreign person is generally required to withhold on the proceeds of the sale, unless an exception applies. Certain foreign pension funds (“qualified foreign pension funds”) are not subject to tax on their sale of a United States Real Property Interest, and similarly, the purchaser of the real property from such a foreign pension fund is not subject to the withholding requirement. The final regulation describes which foreign pension funds are exempt from the tax on the sale of a United States Real Property Interest. The final regulation also describes how a purchaser of a United States Real Property Interest may ascertain that the seller is a qualified foreign pension fund, so that the purchaser is not required to withhold on the proceeds of the sale.

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

26 CFR 1.897(l)-1, 26 CFR 1.1441-3,
26 CFR 1.1445-2, 26 CFR 1.1445-5, 26
CFR 1.1445-8, 26 CFR 1.1446-7

T.D. 9971

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Exception for Interests Held by Foreign Pension Funds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding gain or loss of a qualified foreign pension fund attributable to certain interests in United States real property. The final regulations also include rules for certifying that a qualified foreign pension fund is not subject to withholding on certain dispositions of, and distributions with respect to, certain interests in United States real property. The final regulations affect certain holders of interests in United States real property and withholding agents that are required to withhold tax on dispositions of, and distributions with respect to, such property.

DATES: Effective Date: These regulations are effective on December 29, 2022.

Applicability dates: For dates of applicability, see §§1.897(l)-1(g), 1.1441-3(c)(4)(iii), 1.1445-2(e), 1.1445-5(h), 1.1445-8(j), 1.1446-7.

FOR FURTHER INFORMATION CONTACT: Arielle M. Borsos or Milton Cahn at (202) 317-6937 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 897(l) was added to the Internal Revenue Code (the “Code”) by section 323(a) of the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113, div. Q (the “PATH Act”), and amended by section 101(q) of the Tax Technical Corrections Act of 2018, Pub. L. 115-141, div. U. In the preamble to the updated section 1445 regulations that were published in the **Federal Register** (81 FR 8398-01, as corrected at 81 FR 24484-01) on February 19, 2016, the Department of the Treasury (the “Treasury Department”) and the IRS requested comments regarding what regulations, if any, should be issued pursuant to section 897(l)(3). The Treasury Department and the IRS considered all of the comments received in response to this request and, on June 7, 2019, published proposed regulations under sections 897(l), 1441, 1445 and 1446 in the **Federal Register** (84 FR 26605) (the “proposed regulations”). The proposed regulations contained rules relating to the qualification for the exemption under section 897(l), as well as rules relating to withholding requirements under sections 1441, 1445 and 1446, for dispositions of United States real property interests (“USRPIs”) by foreign pension funds and their subsidiaries and distributions described in section 897(h).

This Treasury decision finalizes the proposed regulations, after taking into account and addressing comments received by the Treasury Department and the IRS with respect to the proposed regulations. Terms used but not defined in this preamble have the meaning provided in the final regulations.

Comments outside the scope of this rulemaking are generally not addressed but may be considered in connection with future regulations. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request.

Summary of Comments and Explanation of Revisions

The final regulations retain the general approach and structure of the proposed regulations, with certain revisions. This Summary of Comments and Explanation of Revisions section discusses the revisions as well as comments received in response to the solicitation of comments in the proposed regulations.

I. *Comments and Revisions Related to the Scope of the Exception*

A. *Qualified controlled entities*

Under the proposed regulations, and consistent with section 897(l), gain or loss of a qualified foreign pension fund (“QFPF”) or a qualified controlled entity (“QCE”) (under the proposed regulations, each generally a “qualified holder”) from the disposition of a USRPI is not subject to section 897(a). Prop. §1.897(l)-1(b)(1). The proposed regulations defined a QCE as a trust or corporation organized under the laws of a foreign country,¹ all of the interests of which are held directly by one or more QFPFs or indirectly through one or more QCEs or partnerships. Prop. §1.897(l)-1(d)(9).

1. Ownership by Non-QFPFs

Several comments received in response to the proposed regulations addressed the ownership requirement with respect to QCEs. The proposed regulations did not permit ownership of a QCE by a person other than a QFPF or another QCE, declining to adopt a comment received before the publication of the proposed regulations requesting that de minimis ownership of a QCE by other persons be disregarded under certain circumstances, such as when de minimis ownership by managers or directors is required by corporate law in certain jurisdictions. The Treasury Department and the IRS determined that permitting a person other than

¹ For consistency with other guidance, the final regulations adopt the term “foreign jurisdiction” instead of “foreign country.” See §1.897(l)-1(e)(4). See also Part II.C. of this Summary of Comments and Explanation of Revisions for a description of how the final regulations treat subnational tax regimes.

a QFPF or another QCE to own an interest in a QCE would impermissibly expand the scope of the exception in section 897(l) by allowing investors other than QFPFs to avoid tax under section 897(a). However, under the proposed regulations, a QFPF could invest in USRPIs with non-QFPFs through a partnership and still qualify for the exemption under section 897(l).

Comments received in response to the proposed regulations similarly requested that the final regulations allow a de minimis exception for the ownership of a QCE by other persons. One comment reiterated that de minimis ownership, including by managers or directors, may be required by corporate law in certain jurisdictions and suggested that the final regulations include a rule that would permit an entity to be treated as a QCE if a small amount (for example, five percent) of the entity is held by a non-QFPF. The comment also suggested that, in order to prevent non-QFPF entities from inappropriately accessing the exemption under section 897(l), a non-QFPF de minimis owner of a QCE could be required to recognize gain or loss on any disposition of a USRPI held through the QCE under section 897(a). The comment asserted that there is no policy reason to differentiate between entities with QFPF and non-QFPF owners/beneficiaries because the entity is a corporation or trust rather than a partnership, and that permitting de minimis non-QFPF ownership of a QCE would allow QFPFs flexibility with regard to the form of entity chosen for investment purposes.

Another comment asserted that a de minimis exception should be allowed because certain jurisdictions may require or otherwise allow investment arrangements in which foreign pension funds pool investments with non-QFPFs. The comment argued that such investment arrangements should not be precluded from qualifying for the exception under section 897(l), especially if those arrangements are allowed or required by local law and are consistent with generally accepted investment practice. The comment suggested that the final regulations permit a non-QFPF to have a de minimis level of ownership (for example, five percent) in a QCE. If a de minimis exception were not adopted, the comment suggested several alternatives to prevent minority investors from tainting the QFPF

status for the majority QFPF investors, including that the final regulations allow QFPFs to qualify for the exception under section 897(l) on their share of income or gains distributed by an investment vehicle, provided the investment vehicle is majority owned by QFPFs. The comment also suggested that the QCE ownership requirement be modified to permit an eligible fund that is a non-QFPF solely because it has a single qualified recipient with a right to more than five percent of the assets or income of the eligible fund to be an owner of a QCE. The comment requested that, in that circumstance, the final regulations look through to the owners of the non-QFPF and apply the prohibition on a single five-percent beneficiary or participant by reference to the would-be QCE rather than the non-QFPF.

An additional comment suggested that a QFPF should be able to claim the section 897(l) exemption with respect to gains derived by an entity in which the QFPF is an investor where the entity is not a partnership and also is not a QCE because it is not wholly owned by QFPFs. The comment noted that, in certain foreign government facilitated arrangements involving a partnership formed under local law through which multiple foreign government entities jointly invest, the investment entity may be a per se corporation under §301.7701-2(b)(6) that would not qualify as a QCE if not all of the government investors were QFPFs. The comment asserted that, in such circumstance, investors would be forced to include a non-government partner so that the investment entity could be treated as a partnership for U.S. federal tax purposes. To address this concern, the comment recommended that the final regulations provide that, if an entity is treated as a partnership under the law of the country in which the QFPF is formed, the QFPF should be able to treat its distributive share of partnership Foreign Investment in Real Property Tax Act (“FIRPTA”) gains as exempt under section 897(l).

The Treasury Department and the IRS continue to believe that allowing any exception with respect to the ownership of a QCE would impermissibly expand the scope of the exception in section 897(l) by allowing investors other than QFPFs to avoid tax under section 897. Section

897(l)(1) expressly provides that an entity must be wholly owned by a QFPF to constitute a QCE and qualify for the exception under section 897(l). Accordingly, the final regulations do not provide a de minimis exception to the ownership of a QCE. For the same reasons, the final regulations do not adopt other suggested approaches that would permit an entity to be a QCE despite limited non-QFPF ownership, such as a tracing approach that would require non-QFPF owners of an entity to be subject to section 897(a) and allow only QFPF owners to benefit from the section 897(l) exemption, or a look-through approach that would allow a non-QFPF that cannot qualify as a QFPF because it violates the rule against having a single five-percent beneficiary or participant to own an interest in a QCE.

The final regulations also do not adopt the recommendation to permit a QFPF to benefit from the section 897(l) exemption with respect to interests in an entity that is classified as a corporation for U.S. federal tax purposes but that does not qualify as a QCE due to ownership by non-QFPFs by treating the entity as a partnership in accordance with its treatment under applicable foreign law. In addition to expanding the definition of a QCE to permit ownership by non-QFPFs, such a rule would contradict the classification of the entity for U.S. federal tax purposes.

2. Investment Arrangements with QFPFs

The proposed regulations permitted multiple QFPFs to wholly own a QCE, either directly or indirectly through one or more other QCEs, in recognition that it is common for QFPFs to pool their investments.

One comment discussed the interaction between the requirement that QCEs must be wholly owned by QFPFs and the various requirements that an eligible fund must meet to maintain its status as a QFPF. The comment stated that a QFPF that invests with other QFPFs in a QCE might fail to qualify for the section 897(l) exemption solely because one of its co-investors fails to qualify as a QFPF in any given year. The comment noted that QFPFs would be required to negotiate complex protections to shield against another co-investor from tainting the

QCE's status. The comment further noted that investing through a partnership (which would allow the QFPF to invest with other non-QFPFs) may not be feasible because a foreign jurisdiction may have regulatory restrictions regarding the types of legal entities in which pension funds may invest or the entity may be wholly owned by QFPFs that form part of a single government (and thus may be a per se corporation under §301.7701-2(b)(6)). The comment therefore recommended that the final regulations provide a rule that a QCE that inadvertently fails to constitute a qualified holder because one of its owners ceases to be treated as a QFPF be permitted, for a limited time, to partially benefit from section 897(l) to the extent that it continues to be owned by QFPFs.

The final regulations do not provide an exception to the requirement that a QCE be wholly owned by a QFPF to insulate QFPF investors from the risk of losing QCE status in investment arrangements with other QFPFs. As with a de minimis exception to the ownership of a QCE, the Treasury Department and the IRS believe that any such rule would impermissibly expand the scope of the section 897(l) exception to allow investors other than QFPFs to avoid tax under section 897. The Treasury Department and the IRS also believe that the changes to the final regulations described in Parts II.A.2 and II.A.3 of this Summary of Comments and Explanation of Revisions will appropriately alleviate concerns with respect to the risk that a QFPF may inadvertently fail to satisfy the requirements to constitute a QFPF.

3. Non-economic Ownership

As referenced in the preamble to the proposed regulations, given the absence of an express provision to the contrary, the definition of an "interest" for purposes of determining whether an entity is a QCE is determined in accordance with §1.897-1(d)(5), which provides that an interest in an entity means an interest in such entity other than an interest solely as a creditor. Section 1.897-1(d)(3) provides that an interest in an entity other than solely as a creditor is: (A) stock of a corporation; (B) an interest in a part-

nership as a partner within the meaning of section 761(b) and the regulations thereunder; (C) an interest in a trust or estate as a beneficiary within the meaning of section 643(c) and the regulations thereunder or an ownership interest in any portion of a trust as provided in sections 671 through 679 and the regulations thereunder; (D) an interest which is, in whole or in part, a direct or indirect right to share in the appreciation in value of an interest in an entity described in subdivision (A), (B), or (C) of §1.897-1(d)(3) (i) or a direct or indirect right to share in the appreciation in value of assets of, or gross or net proceeds or profits derived by, the entity; or (E) a right (whether or not presently exercisable) directly or indirectly to acquire, by purchase, conversion, exchange, or in any other manner, an interest described in subdivision (A), (B), (C), or (D) of §1.897-1(d)(3)(i).

One comment requested that the final regulations clarify that non-economic interests in an entity are not taken into account in determining whether an entity is a QCE. The comment noted that such a situation might arise when a foreign partnership that elects to be treated as a corporation for U.S. federal income tax purposes has a general partner that holds no economic interest in the entity. The comment recommended that the final regulations provide that interests in a QCE that do not entitle the holders to share in the income or assets of the QCE should be ignored in determining whether the QCE is a qualified holder, noting that such fully non-economic interests do not present potential for abuse and that disregarding those interests would be consistent with congressional intent to accommodate a variety of foreign pension fund structures under section 897(l).

The Treasury Department and the IRS do not believe that additional guidance is necessary regarding the ownership interests taken into account in determining whether an entity constitutes a QCE. Thus, an "interest" for purposes of determining whether an entity is a QCE is determined under §1.897-1(d)(3). Whether an interest in an entity constitutes one of the interests listed under §1.897-1(d)(3) or is instead disregarded is determined based on the facts, taking into account general tax principles.

B. Qualified holder rule

The proposed regulations provided that a qualified holder does not include any entity or governmental unit that, at any time during the testing period, determined without regard to this limitation, was not a QFPF, a part of a QFPF, or a QCE (the "qualified holder rule"). See Prop. §1.897(l)-1(d)(11)(ii). For this purpose, the proposed regulations provided that the testing period is the shortest of (i) the period beginning on the date that section 897(l) became effective (December 18, 2015), and ending on the date of a disposition described in section 897(a) or a distribution described in section 897(h); (ii) the ten-year period ending on the date of the disposition or the distribution; or (iii) the period during which the entity (or its predecessor) was in existence. See Prop. §1.897(l)-1(d)(14). Under the proposed regulations, the qualified holder rule does not apply to an entity or governmental unit that did not own a USRPI as of the date it became a QCE, a QFPF, or part of a QFPF. The preamble to the proposed regulations explained that the qualified holder rule is necessary to prevent the inappropriate avoidance of section 897(a) through QFPFs indirectly acquiring USRPIs held by foreign corporations that would not have otherwise qualified for the exception under section 897(l).

Comments recommended that the final regulations either modify the qualified holder rule or implement one of several alternatives. Comments agreed that the QFPF exception should not apply to exempt gain that would otherwise have been subject to tax under section 897. However, the comments argued that the qualified holder rule in the proposed regulations was overbroad because it could apply to any failure to qualify as a QFPF or QCE in the testing period, even if the failure was unintentional or had no potential for abuse.

One comment requested that the final regulations provide a tolling period if there is an inadvertent failure to qualify as a QFPF and that failure is remedied in the following year. Another comment requested that the final regulations provide an exception to the qualified holder rule to exclude the situation in which a QFPF does not qualify solely because it

fails to meet the requirements in proposed §1.897(l)-1(c)(2) (relating to the requirements an eligible fund must satisfy to be treated as a QFPF). The comment further recommended allowing a mark-to-market approach, whereby an election to recognize any net built-in gain at the time a QFPF acquires a non-QFPF that owns a USRPI could be made so that the non-QFPF could then be treated as a QCE with respect to any future disposition of its USRPI (similar to §1.337(d)-7(a) for the conversion of certain corporations to regulated investment companies (“RIC”) or real estate investment trusts (“REIT”)). In addition, the comment requested that the qualified holder rule be limited to apply only to USRPIs held by non-QFPFs when such non-QFPFs are acquired by a QFPF, resulting in a tracing approach that would prevent section 897(l) from applying only to a disposition of those specific USRPIs. The comment also recommended that the final regulations shorten the maximum testing period from ten to five years, which is consistent with the five-year maximum testing period for a RIC or REIT to be a domestically controlled qualified investment entity under section 897(h)(4).

As alternatives to the qualified holder rule, one comment requested that the Treasury Department and the IRS either allow a mark-to-market approach at the taxpayer’s election (similar to that suggested by other comments), under which the entity acquired by the QFPF would account for the gain when the entity is acquired by the QFPF, or require tracing the unrealized gain when the entity is acquired by a QFPF or QCE so that section 897(a) can apply to the pre-acquisition gain upon a subsequent sale or exchange.

Under the final regulations, the substance of the qualified holder rule is the same as it was in the proposed regulations; however, for greater clarity, the final regulations identify the qualified holder rule as a separate requirement to qualify for the section 897(l) exemption rather than as part of the definitions. §1.897(l)-1(d). To be a qualified holder, a QFPF or a QCE must satisfy one of two alternative tests at the time of the disposition of the USRPI or the distribution described in section 897(h). §1.897(l)-1(d)(1). Under the first test, a QFPF or a QCE is a qualified holder if it owned no USRPIs as of the ear-

liest date during an uninterrupted period ending on the date of the disposition or distribution during which it qualified as a QFPF or a QCE. §1.897(l)-1(d)(2). Alternatively, if a QFPF or a QCE held USRPIs as of the earliest date during the period described in the preceding sentence, it can be a qualified holder only if it satisfies the applicable testing period requirement, which is unchanged from the proposed regulations. §1.897(l)-1(d)(3).

The final regulations also include two transition rules. First, with respect to any period from December 18, 2015, to the date when the requirements of section 1.897(l)-1(c)(2) or (e)(9) first apply to a QFPF or QCE, as applicable (but in any event no later than December 29, 2022, in the case of section 1.897(l)-1(c)(2), and no later than June 6, 2019, in the case of section 1.897(l)-1(e)(9)), the QFPF or QCE is deemed to satisfy the requirements of section 1.897(l)-1(c)(2) and (e)(9), as applicable, for purposes of section 1.897(l)-1(d)(2) and (3) if the QFPF or QCE satisfies the requirements of section 897(l)(2) based on a reasonable interpretation of those requirements (including determining any applicable valuations using a consistent method). Second, in determining whether a QCE is a qualified holder, solely with respect to the two tests in section 1.897(l)-1(d)(2) and (3), the final regulations allow the QCE to disregard a de minimis interest owned by any person that provides services to the QCE from December 18, 2015 to February 27, 2023 (the “transition period”). §1.897(l)-1(d)(4)(ii). This second transition rule does not apply for purposes of determining QCE status under section 1.897(l)-1(e)(9) at the time of any disposition or distribution involving a USRPI. Thus, its application is limited to cases in which a trust or corporation failed to qualify as a QCE (and, therefore, as a qualified holder) during the transition period solely because of a de minimis interest owned by any person that provides services to the QCE (such as a manager or director). In that case, the transition rule allows the trust or corporation to eliminate the service provider’s ownership within the transition period and thereby avoid having to apply the tests for qualified holder status under section 1.897(l)-1(d)(2) or (3) by reference to the date that the service provider’s interest

is eliminated. This may, for example, prevent the restarting of a ten-year testing period on the date that the service provider’s interest is eliminated. Any disposition of USRPIs during the period when the trust or corporation had the service provider as an interest holder still would not qualify for the section 897(l) exemption.

The Treasury Department and the IRS agree that the application of the qualified holder rule to an inadvertent failure to qualify as a QFPF could produce inappropriate results, particularly in the case where an eligible fund fails to meet the requirements in §1.897(l)-1(c)(2)(ii)(B)(2) because it unexpectedly projects that it will provide less than 85 percent retirement and pension benefits. Although the final regulations ultimately adopt the qualified holder rule without the changes recommended by the comments, the final regulations provide relief in the following ways:

- adding an alternative calculation to the requirements in §1.897(l)-1(c)(2)(ii)(B)(2) and (3) based on the average of the present values of the future benefits expected to be provided, as determined in the 48 months preceding (and including) the most recent valuation (the “48-month alternative calculation,” described further in Part II.A.2 of this Summary of Comments and Explanation of Revisions);
- adding a definition of retirement and pension benefits;
- clarifying the scope of ancillary benefits; and
- allowing an eligible fund to provide a de minimis amount of non-ancillary benefits (described further in Part II.A.3 of this Summary of Comments and Explanation of Revisions).

Together, these changes provide relief to eligible funds that would otherwise unexpectedly fail to qualify as a QFPF in any given year and alleviate the underlying concerns regarding the breadth of the qualified holder rule.

In light of the changes described in the preceding paragraph, the final regulations do not adopt the recommendation to allow a tolling period to remedy the loss of QFPF status. For the same reasons, the final regulations also do not adopt the recommendation to provide an exception to

the qualified holder rule for any failure to meet the requirements in §1.897(l)-1(c)(2) or to have the qualified holder rule apply only to USRPIs owned by non-QFPFs when such non-QFPFs are acquired by a QFPF. The section 897(l) exception provides a substantial benefit to investors, and it is appropriate to require an eligible fund to meet the requirements in the final regulations for a ten-year maximum testing period before obtaining tax-free treatment to ensure the exception is not claimed inappropriately. Cf. section 877 (requiring taxpayer to be subject to potential additional U.S. taxation for ten years after relinquishing U.S. citizenship); §§1400Z-2 (allowing taxpayer to receive a step-up in basis of property equal to its fair market value if held for ten years); 1.937-2(f) (requiring individual to be bona fide resident of a territory for 10 years before sale of property is sourced to territory and receives beneficial tax rate). Accordingly, the final regulations also do not adopt a maximum testing period that is shorter than ten years.

With respect to the suggested alternatives to the qualified holder rule, the preamble to the proposed regulations explained that the mark-to-market and tracing approaches both imposed greater compliance and administrative costs relative to the testing-period approach without providing any accompanying general economic benefit. Even if the investor is given the option to elect a mark-to-market approach, it would still present compliance and administrative barriers because fair market valuations of real property are not readily available. The tracing approach would similarly impose compliance and administrative burdens, as such an approach would require obtaining a fair market valuation of real property when an entity became a QCE, as well as tracking the USRPIs that were acquired before the entity became a QCE so that the pre-acquisition built-in gain could be recognized upon a later disposition. Accordingly, the final regulations do not adopt the mark-to-market or tracing alternatives.

C. Qualified segregated accounts

The proposed regulations provided that a qualified holder is exempt from section 897(a) only with respect to gain or loss

that is attributable to one or more qualified segregated accounts maintained by the qualified holder. Prop. §1.897(l)-1(b)(2). The proposed regulations defined a qualified segregated account as an identifiable pool of assets maintained for the sole purpose of funding qualified benefits (that is, retirement, pension, or ancillary benefits) to qualified recipients (generally, plan participants and beneficiaries). See Prop. §1.897(l)-1(d)(13)(i). The proposed regulations provided separate standards for determining whether an identifiable pool of assets is maintained for the sole purpose of funding qualified benefits depending on whether the pool of assets is maintained by an eligible fund (including an eligible fund that satisfies the requirements to be treated as a QFPF) or a QCE. See Prop. §1.897(l)-1(d)(13)(ii); Prop. §1.897(l)-1(d)(13)(iii).

Comments requested that the final regulations clarify the standards that apply for determining whether an identifiable pool of assets is maintained for the sole purpose of funding qualified benefits, and one comment recommended removing the standards altogether. Specifically, comments identified several situations in which qualified segregated accounts are maintained for the sole purpose of funding qualified benefits to qualified recipients, but where the funds could nevertheless be disbursed for other purposes or to non-qualified recipients. For example, one comment noted that an eligible fund could rebate an overfunded amount by a foreign defined benefit pension fund to an employer. Another comment noted that assets might not be disbursed to qualified recipients or used to pay reasonable plan expenses if a potential change in foreign law impacts how fund assets can be used. One comment highlighted that assets might revert to sponsoring employers if employees cease participating in the plan before their benefits have vested. Another comment cited the possibility that upon a dissolution of the eligible fund, assets could revert to the employer after satisfying its obligations to qualified recipients and creditors. In each such situation, the comments recommended that the final regulations clarify that a pool of assets would not fail to qualify as a qualified segregated account. One comment further recommended that the final regulations

eliminate the requirement that all income and assets maintained in a qualified segregated account of an eligible fund be used to fund the provision of qualified benefits to qualified recipients because such a provision is unnecessary to ensure that income and assets of an eligible fund do not inure to inappropriate recipients.

The Treasury Department and the IRS agree that in certain situations the reversion of funds to a governmental unit or an employer, after satisfaction of liabilities to creditors and qualified recipients, should not disqualify the account from being treated as maintained for the sole purpose of funding qualified benefits to be provided to qualified recipients. Accordingly, the final regulations clarify that a qualified segregated account that is held by an eligible fund is treated as maintained for the sole purpose of funding qualified benefits to be provided to qualified recipients notwithstanding that funds may revert (such as upon dissolution or the benefits failing to vest) to the governmental unit or employer in accordance with applicable foreign law so long as contributions to the plan are not more than what is reasonably necessary to fund the qualified benefits to be provided to qualified recipients. §1.897(l)-1(e)(13)(i). This requirement ensures that a governmental unit or employer does not qualify for benefits under section 897(l) to the extent it inappropriately overfunds the plan.

One comment further recommended that the final regulations treat an eligible fund's interest in a corporation as a qualified segregated account. This recommendation was made to resolve the issue, described in Part I.A.1 of this Summary of Comments and Explanation of Revisions, that arises when multiple foreign government entities, some of which are QFPFs and some of which are not, jointly invest in USRPIs through a foreign partnership that is treated as a per se corporation for U.S. federal tax purposes (pursuant to §301.7701-2(b)(6)), but cannot qualify as a QCE because not all of the investors are QFPFs.

The final regulations do not adopt this recommendation for several reasons. First, the suggestion contemplates a situation that is contrary to the requirement in section 897(l)(1) that requires an entity to be wholly owned by a QFPF in order

to qualify for the exception under section 897(l). Thus, the recommendation potentially allows the exemption from taxation under section 897(a) to inure to non-QF-PFs. Second, the issue described in the comment ultimately arises because of the rule under §301.7701-2(b)(6) rather than the final regulations, and therefore a modification to the final regulations is not the appropriate resolution. Third, the recommendation does not ensure that the assets or income of the corporation are used only for the purpose of providing benefits to qualified recipients, a key purpose of the qualified segregated account rules.

II. Comments and Revisions Relating to Requirements Applicable to a QFPF

A. Established to provide retirement and pension benefits

The proposed regulations allowed pension funds established by one or more employers and government-sponsored public pension funds to be considered QFPFs. Specifically, the proposed regulations provided that an eligible fund must be established by either (i) the foreign country in which it is created or organized to provide retirement or pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers (“government-established fund”), or (ii) one or more employers to provide retirement or pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees in consideration for services rendered by such employees to such employers (“employer fund”). Prop. §1.897(l)-1(c)(2)(ii)(A). The language in proposed §1.897(l)-1(c)(2)(ii)(A) generally reflected the statutory language in section 897(l)(2)(B).

1. Pension Funds Eligible for Section 897(l)(2)(B)

a. “Established by” requirement

One comment requested that the final regulations clarify the requirement that an eligible fund be “established by” a foreign government in the case of a gov-

ernment-established fund. The comment expressed concern that the “established by” requirement in the proposed regulations could exclude the national pension systems of certain countries under which accounts in the names of individual participants are maintained by private entities. The comment explained that some foreign countries have pension systems in which all employees (or employees working in a certain sector of the economy) are required by law to establish a pension account held and managed by a private pension administrator. Although the arrangement is created by government mandate and subject to government regulation, the private pension administrators form the investment vehicles, select the investment advisors, and receive, invest, and disburse the funds. The extent of additional government involvement varies, but could include the government being the conduit through which contributions by employers and employees are funneled into the plans or benefits are disbursed. The comment asserted that such an arrangement should be treated as “established by” the foreign government for purposes of qualifying as a government-established fund and that each private pension administrator, the investment vehicles that it establishes, and any government office that is within the flow of funds should be treated as part of an “arrangement” that maintains qualified segregated accounts. According to the comment, if participation in the pension system is mandatory, a foreign government should meet the “established by” requirement for a government-established fund even if the government does not actually receive contributions and disburse benefits or hold or invest the funds. The comment recommended that the final regulations clarify that an arrangement created pursuant to a foreign government mandate, but in which private investment managers hold and invest contributions, should be treated as “established by” the foreign government.

The Treasury Department and the IRS recognize that eligible funds in foreign countries may be established and administered in numerous ways. The Treasury Department and the IRS also continue to believe that the purpose of section 897(l) is best served by permitting a broad range of structures to be treated as a QFPF. Ac-

cordingly, the final regulations clarify that an eligible fund may be established by, or at the direction of, a foreign jurisdiction for purposes of qualifying as a government-established fund. §1.897(l)-1(c)(2)(ii)(A)(1)(i). If an eligible fund is established at the direction of a foreign jurisdiction to provide benefits to the establishing entity’s employees in consideration for services rendered to the establishing entity, the final regulations clarify that the fund will be considered an employer fund only. §1.897(l)-1(c)(2)(ii)(A)(2). Finally, the final regulations clarify that an eligible fund is treated as being established by a foreign jurisdiction or an employer notwithstanding that one or more persons that are not the foreign jurisdiction or employer administers the eligible fund. §1.897(l)-1(c)(2)(ii)(A)(3). Thus, an arrangement created pursuant to a foreign government mandate in which private investment managers hold and invest contributions is treated as “established by” the foreign government.

b. Employer fund established by foreign government

One comment indicated that, under the proposed regulations, it was not clear that a QFPF could include pension arrangements established by governmental units in their function as employers, while also noting that such funds could potentially qualify as both a government-established fund and an employer fund. The comment recommended clarifying that an otherwise qualifying pension fund can be established by government employers.

The final regulations clarify that an eligible fund can be established by a governmental unit acting in its capacity as an employer, and specify that such a fund constitutes an employer fund. §1.897(l)-1(c)(2)(ii)(A).

2. Purpose of Eligible Fund

Proposed §1.897(l)-1(c)(2)(ii)(B) required that all of the benefits that an eligible fund provides are qualified benefits to qualified recipients (the “100 percent threshold”), and that at least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide in the future are retirement or

pension benefits (the “85 percent threshold”). For this purpose, qualified benefits were defined as retirement, pension, or ancillary benefits. Prop. §1.897(l)-1(d)(8). As discussed in the preamble to the proposed regulations, the Treasury Department and the IRS adopted the 85 percent threshold because it was more administrable and provided more certainty to taxpayers than a subjective standard. The preamble to the proposed regulations indicated that the calculation of the 85 percent threshold would be made on an annual basis, but the proposed regulations did not explicitly identify a period for making this determination.

a. Comments received

Several comments stated that a strict numerical threshold created a cliff effect and caused uncertainty as to whether an eligible fund would qualify as a QFPF on a consistent basis over several years. Particular concern was expressed by one comment that an annual test may cause disqualification as a QFPF for reasons not entirely within the eligible fund’s control, such as when the population of qualified recipients changes. Other comments stated that the present value calculation in the proposed regulations was vague, and one comment stated that the proposed regulations did not clearly identify the frequency with which the reasonable expectation of present value should be calculated.

Based on these observations, several comments suggested that the objective 85 percent threshold should be replaced with a subjective test assessing the fund’s purpose. These comments suggested that instead of the 85 percent threshold, a fund’s purpose should be determined, considering all the facts and circumstances, by assessing whether the fund was established to provide retirement and pension benefits. Comments also suggested that the 85 percent threshold could be used as a safe harbor; a fund that does not meet that requirement would then have to show that it was established to provide retirement and pension benefits given all the facts and circumstances. One comment suggested another safe harbor whereby any fund that did not meet the 85 percent threshold could still qualify as a QFPF on a propor-

tionate basis by comparing the present value of the retirement and pension benefits the fund reasonably expects to pay to the present value of all benefits it reasonably expects to pay.

Several comments stated that if the 85 percent threshold were retained, the final regulations should provide guidance on the assumptions that may be made in making the present value calculation, including the frequency of the calculation. One comment suggested that forecasts of anticipated future benefits that are already prepared by the eligible fund should be considered reasonable if they are based on data that the fund prepares for general business purposes in accordance with internal procedures. Another comment suggested that reasonable actuarial standards applied in good faith could be a basis for this calculation.

In addition, several comments requested that the final regulations provide relief if a fund does not qualify as a QFPF in a particular year. These comments suggested that a look-back rule allow eligible funds to calculate compliance with the 85 percent threshold over a multi-year period, such as three years, rather than on an annual basis. One comment suggested other alternatives, such as providing a grace period during which a fund could regain compliance as a QFPF without losing its exempt status or the granting of proportionate eligibility as a QFPF.

b. 85 percent threshold

The Treasury Department and the IRS continue to believe that the 85 percent threshold is more administrable and provides more certainty than a subjective standard for determining whether an eligible fund is established to provide retirement and pension benefits. The Treasury Department and the IRS also continue to believe that this threshold allows an appropriate margin for nonconforming benefits. Accordingly, the final regulations retain the 100 percent threshold and 85 percent threshold, and do not adopt a subjective standard. §1.897(l)-1(c)(2)(ii)(B). However, several other comments suggesting further clarity or relief with respect to the 85 percent threshold are incorporated in the final regulations, as described in paragraphs II.A.2.c. and II.A.2.d. of this

Summary of Comments and Explanation of Revisions.

c. Clarifications regarding present valuation

The Treasury Department and the IRS believe that further guidance with respect to determining the present value of benefits that an eligible fund reasonably expects to provide is appropriate. To clarify what this calculation is intended to value, the final regulations state that the eligible fund must measure the present value of benefits to be provided during the entire period during which the fund is expected to be in existence. §1.897(l)-1(c)(2)(ii)(C)(I). Comments articulated different, though potentially overlapping, benchmarks for determining what valuation methods would be considered reasonable—for example, making the determination based on data prepared for general business purposes in accordance with internal procedures or based on actuarial standards applied in good faith. As a result, the Treasury Department and the IRS have decided to use a broad standard that would accommodate all such suggestions by providing that an eligible fund may utilize any reasonable method for determining present value. *Id.* Although the final regulations are intended to provide flexibility as to the method used for determining present value, the Commissioner may determine that the present valuation requirement is not satisfied if the relevant facts and circumstances indicate that the method used was unreasonable (for example, it may be relevant that the method used results in a percentage calculation of retirement and pension benefits that differs materially from the actual percentage of the retirement and pension benefits provided before the most recent present valuation date). See also §1.897(l)-1(c)(3)(iii) for the requirement that an eligible fund maintain records to show it meets the requirements of §1.897(l)-1(c)(2), which is discussed in Part III.B. of this Summary of Comments and Explanation of Revisions.

The Treasury Department and the IRS believe that further guidance is also appropriate with respect to the frequency with which the valuation needs to be made. The final regulations state that such a determination must be made on at least an annual

basis. §1.897(l)-1(c)(2)(ii)(C)(1). Thus, for example, if an eligible fund changes its taxable year and has a short taxable year, the eligible fund may make its present value determination for the short taxable year provided that it makes another present value determination within one year. Consistent with the above, the final regulations clarify that an eligible fund must use its most recent present value determination (or its most recent 48-month alternative calculation, described in Part II. A.2.d. of this Summary of Comments and Explanation of Revisions) with respect to dispositions of USRPIs or distributions described in section 897(h) that occur during the twelve months that succeed such present value determination (or 48-month alternative calculation), or until a new present value determination is made, whichever occurs first. §1.897(l)-1(c)(2)(ii)(C)(3).

d. 48-month average alternative

Finally, the Treasury Department and the IRS agree that because unanticipated events may cause a fund to fail the 85 percent threshold in any one year, the fund should still qualify as a QPPF if it shows that it has consistently qualified as such over an extended period. The final regulations therefore adopt a 48-month alternative calculation test as another means to satisfy the 85 percent threshold. §1.897(l)-1(c)(2)(ii)(C)(2). The 48-month alternative calculation test is satisfied if the average of the present values of the retirement and pension benefits the eligible fund reasonably expected to provide over its life, as determined by the valuations performed over the 48 months preceding (and including) the most recent present valuation, satisfies the 85 percent threshold.² The determination of such average is based on the values (not percentages) of the qualified benefits the eligible fund reasonably expected to provide. In addition, the 48-month alternative calculation must be determined using a weighted average whereby values are adjusted, if necessary, when the length of valuation periods differs.³ If an eligible fund has been in existence for less than 48 months, the

48-month alternative calculation is applied to the period the eligible fund has been in existence. The 48-month alternative calculation may be satisfied based on any reasonable determination of the present valuation for any period that starts before the date that the valuation requirements first apply to an organization or arrangement and ends on or before December 29, 2022.

While the comments and related changes to the final regulations described above apply to the 85 percent threshold, similar rules have also been added for consistency with respect to the new category of non-ancillary benefits added to the final regulations and further described in Part II.A.3.b of this Summary of Comments and Explanation of Revisions.

3. Qualified Benefits

a. Retirement and pension benefits

The proposed regulations did not provide a definition of retirement and pension benefits. Rather, in the preamble to the proposed regulations, the Treasury Department and the IRS requested comments on whether the regulations should define retirement and pension benefits (for example, with reference to whether there are penalties for early withdrawals).

Although one comment suggested that the term retirement and pension benefits was clear and did not require a definition, most comments requested that the final regulations provide a definition of retirement and pension benefits. Comments recommended several sources that the final regulations might refer to in defining retirement and pension benefits, including the Employee Retirement Income Security Act of 1974 (“ERISA”), U.S. federal income tax law principles (for example, Chapter 1, Subchapter D of the Code and corresponding Treasury Regulations), and income tax treaties. One comment suggested that the final regulations provide separate definitions of retirement and pension benefits based in part on these sources of U.S. tax law. This comment generally proposed defining retirement benefits as

those benefits that are paid after reaching a predetermined retirement age that are provided in return for services rendered or contributions made. The comment generally proposed defining pension benefits as those benefits paid after the participant retires due to a proven disability before having reached a predetermined retirement age or paid to surviving beneficiaries if the participant dies before reaching the predetermined retirement age and that are provided in return for services rendered or contributions made.

In response to these comments and to provide greater clarity, the final regulations provide a definition of retirement and pension benefits. Furthermore, the final regulations adopt a broad definition of retirement and pension benefits to ensure that a wide variety of pension funds and foreign laws are accommodated. Thus, the final regulations provide that retirement and pension benefits mean benefits payable to qualified recipients after reaching retirement age under the terms of the eligible fund, or after an event in which the eligible fund recognizes that a qualified recipient is permanently unable to work, and including any such distribution made to a surviving beneficiary of the qualified recipient. §1.897(l)-1(e)(14). The inclusion of payments of accrued benefits after a specified event that results in a permanent disability (such that the qualified recipient is unable to work) or survivor benefits in the definition of retirement and pension benefits is intended to resolve concerns expressed in comments regarding the potential overlap of such benefits with the benefits listed in the definition of ancillary benefits in proposed §1.897(l)-1(d)(1) (for example, the proposed definition of ancillary benefits included death and disability benefits). To provide additional clarity regarding the factors that would indicate whether a benefit is a retirement and pension benefit, as well as the distinction between retirement and pension benefits and ancillary benefits, the final regulations also provide that retirement and pension benefits are generally based on contributions and investment performance, as well as factors such as years of service with

²The Commissioner may determine that the 48-month alternative calculation is not satisfied if, as discussed in Part II.A.2.c of this Summary of Comments and Explanation of Revisions, the relevant facts and circumstances indicate that the method used to determine present value was unreasonable.

³The length of the valuation periods may differ if the eligible fund performs valuations more than once a year.

an employer and compensation received by the qualified recipient. *Id.* The final regulations do not require retirement and pension benefits to be paid in a particular manner (that is, an annuity versus a lump-sum).

b. Ancillary and non-ancillary benefits

The proposed regulations defined ancillary benefits to mean benefits payable upon the diagnosis of a terminal illness, death benefits, disability benefits, medical benefits, unemployment benefits, or similar benefits. Prop. §1.897(l)-1(d)(1).

As discussed in Part II.A.2 of this Summary of Comments and Explanation of Revisions, numerous comments requested that the final regulations provide clarifications and incorporate flexibility into the definition of ancillary benefits in light of the cliff effect caused by the use of the 100 percent and 85 percent thresholds to determine whether an eligible fund qualifies as a QFPF. Comments highlighted that the funds may be allowed, or required, to provide certain benefits to its participants or beneficiaries that are not enumerated in the definition of ancillary benefits, such as limited withdrawals to fund a first home. Comments expressed concern that the provision of such a benefit would disqualify the plan from the exemption under section 897(l) because such a benefit is not listed in the definition of ancillary benefits, it is not certain whether such benefit is a “similar benefit,” and the numerical thresholds do not allow for the provision of any benefits other than retirement and pension or ancillary benefits. The comments argued that the provision of such benefits should not disqualify the plan from the exemption under section 897(l) because, generally, the provision of such benefits is not the main purpose of the plan and represents only a small portion of the benefits paid out by the plan.

Comments suggested clarifying the scope of the term “similar benefits” in the definition of ancillary benefits and expanding the definition of ancillary benefits to include any benefits that are allowed or required to be paid under the laws of the foreign jurisdiction in which the fund is created or organized. Comments also argued that a broad category of ancillary or other benefits tied to the benefits allowed

under foreign law is needed to accommodate potential changes to the type of benefits allowed under foreign pension regimes. One comment recommended that such a rule also apply where pension plans and non-qualifying plans providing for other types of benefits are required by foreign law to be pooled into one fund or arrangement, which might otherwise preclude an eligible entity from being a QFPF even though it is predominantly a pension fund.

Several comments recommended that the final regulations allow for a fund to provide a de minimis amount of benefits that are neither retirement and pension benefits nor any of the benefits listed under the definition of ancillary benefits in the proposed regulations. One comment recommended permitting a de minimis percentage of the total benefits provided by a fund (for example, up to five percent) to be any benefits that are not retirement and pension benefits or specifically listed in the definition of ancillary benefits, provided the benefits are required or allowed to be paid under the laws of the foreign jurisdiction where the fund is created or organized. Another comment, citing the broad range of foreign pension arrangements and the lack of clear guidance in certain jurisdictions regarding the potential benefits that can be provided by pension arrangements, suggested a de minimis amount (for example, three percent) of total benefits be allowed for non-ordinary benefits that fall outside the scope of the definition of ancillary benefits.

Several comments also noted that certain of the benefits enumerated in the definition of ancillary benefits in the proposed regulations may be more closely related to the payment of retirement and pension benefits. For example, one comment noted that a participant or beneficiary may be eligible to make withdrawals of their retirement and pension benefits before reaching retirement age upon permanent disability or diagnosis of a terminal illness. These and other types of similar benefits, such as survivor benefits (that is, payments of the beneficiary or participant’s retirement and pension benefits to a surviving designee upon the death of the beneficiary or participant), are paid in recognition of past service or because the plan participant is unable to continue working or care for

their dependents. In such cases, the benefit is effectively being paid as a retirement and pension benefit, but such benefit could improperly be considered an ancillary benefit under the definition in proposed §1.897(l)-1(d)(1). Another comment similarly noted that ancillary benefits should not refer to annuities payable to surviving beneficiaries or on early retirement because of a disability and suggested that the definition of ancillary benefits be modified to refer only to certain one-time payments made in connection with disability, terminal illness, or death. One comment noted that many benefits that otherwise might be ancillary benefits, such as medical and disability benefits, are often available principally to retirees. Thus, comments recommended that the definition of ancillary benefits be clarified such that benefits that are more appropriately characterized as retirement and pension benefits are not inappropriately treated as ancillary benefits.

In response to the comments, the final regulations provide additional clarity with respect to the types of benefits permitted to be provided by a QFPF.

First, as discussed in Part II.A.3.a of this Summary of Comments and Explanation of Revisions, the final regulations provide a definition of retirement and pension benefits, which is intended to clarify that certain benefits that may have potentially been categorized as ancillary benefits under the proposed regulations are retirement and pension benefits. This definition should assist in distinguishing retirement and pension benefits from ancillary benefits and, because more benefits should be characterized as retirement and pension benefits, should lessen the concern that the provision of ancillary benefits will jeopardize qualification as a QFPF.

Second, the final regulations modify the definition of ancillary benefits by providing a more detailed list of specific types of benefits that meet the ancillary benefits definition. §1.897(l)-1(e)(1). The revised definition clarifies that, in addition to benefits payable upon the diagnosis of a terminal illness, medical benefits, or unemployment benefits, ancillary benefits also include incidental death benefits (for example, funeral expenses), short-term disability benefits, life insurance benefits, and shutdown or

layoff benefits. To distinguish between unemployment, shutdown, or layoff benefits that might also be considered retirement and pension benefits, the final regulations state that those types of benefits will be considered ancillary benefits only if they do not continue past retirement age and do not affect the payment of accrued retirement and pension benefits. §1.897(l)-1(e)(1)(i)(B). In addition, the final regulations clarify what benefits are considered similar to the specifically identified ancillary benefits by indicating that such similar benefits should also be either health-related or unemployment benefits. §1.897(l)-1(e)(1)(i)(C). Lastly, for the avoidance of doubt, the final regulations resolve any potential overlap between the definitions of retirement and pension benefits and ancillary benefits by providing that if any benefits fall within both definitions, they are only considered to be retirement and pension benefits. §1.897(l)-1(e)(1)(ii). The Treasury Department and the IRS intend for this rule to have limited application given the definitions of retirement and pension benefits and ancillary benefits provided in the final regulations.

Third, the Treasury Department and the IRS have determined that it is appropriate to permit a limited amount of benefits that are outside the scope of retirement and pension benefits and ancillary benefits. The final regulations therefore allow an eligible fund to provide a limited amount of non-ancillary benefits, which the final regulations define as any benefits provided by the eligible fund as permitted or required under the laws of the foreign jurisdiction in which the fund is established or operates that do not otherwise fall within the definition of retirement and pension benefits or ancillary benefits. §1.897(l)-1(e)(6). The final regulations provide that no more than five percent of the present value of the qualified benefits the eligible fund reasonably expects to provide to qualified recipients during the entire period during which the eligible fund is expected to be in existence can be non-ancillary benefits. §1.897(l)-1(c)(2)(ii)(B)(3). This measurement of non-ancillary benefits is determined under the same rules that apply to the present valuation of retirement and pension benefits for purposes of the 85 percent threshold, which are described in

Part II.A.2 of this Summary of Comments and Explanation of Revisions.

The final regulations incorporate the allowance for non-ancillary benefits into the 100 percent threshold by revising the definition of “qualified benefits” in the proposed regulations. Specifically, non-ancillary benefits and ancillary benefits, together with the new definition of retirement and pension benefits, comprise the “qualified benefits” that an eligible fund must provide to meet the 100 percent threshold. §1.897(l)-1(e)(8).

c. Other distributions and early withdrawals

The proposed regulations did not explicitly address how early withdrawals from a QFPF should be treated for purposes of determining the amount of retirement or other benefits paid by the QFPF. Specifically, the proposed regulations did not discuss how to treat withdrawals made from one retirement plan and rolled over into a different retirement plan, early withdrawals that certain plans may permit in accordance with country-specific laws, or loans made by an eligible fund. One comment suggested that rollover distributions should not be considered as benefits paid by a plan and thus should be excluded when determining an eligible fund’s eligibility as a QFPF. The comment also recommended that in-service plan withdrawals or loans should not be taken into account in calculating the benefits paid by an eligible fund provided that in-service withdrawals before retirement age are permissible under the plan terms or relevant law.

The Treasury Department and the IRS have considered these recommendations and generally agree that the types of withdrawals described above should not be taken into account when calculating the 100 percent threshold, the 85 percent threshold, or the limitation on non-ancillary benefits. As a result, the final regulations add three categories of distributions that are excluded when making these determinations. §1.897(l)-1(c)(2)(ii)(D).

The first category is a loan to a qualified recipient pursuant to terms set by the eligible fund. Because there is an expectation of repayment, these types of loans should not be included when mak-

ing threshold benefit determinations. This category, however, excludes a loan that a qualified recipient is not required to repay, in full or in part, upon default (which would generally constitute the provision of a non-ancillary benefit), unless such a default is subject to tax and penalty in a foreign jurisdiction.

The second category is a distribution permitted under the laws of the foreign jurisdiction in which the eligible fund is established or operates and made before the participant or beneficiary reaches the retirement age as determined under relevant foreign laws, but only if the distribution is to a qualified holder or other retirement or pension arrangement subject to similar distribution or tax rules under the laws of the foreign jurisdiction. Such rollover distributions are simply shifting funds between one eligible fund and another similar fund (even if such fund does not qualify as a QFPF) and thus should also be excluded when making the 100 percent and 85 percent threshold determinations.

The third category is a withdrawal of funds before the participant or beneficiary reaches retirement age to satisfy a financial need under principles similar to the U.S. hardship distribution rules permitted under the laws of the foreign jurisdiction in which the eligible fund is established or operates, provided the distribution (or at least the portion of the distribution exceeding basis) is subject to tax and penalty in such foreign jurisdiction. Because the qualified recipient bears some or all of the financial burden with regard to such hardship withdrawals, they are excluded when making threshold benefit determinations.

4. Qualified Recipient

Proposed §1.897(l)-1(c)(2)(ii)(B)(I) required that all the benefits that an eligible fund provides be qualified benefits to qualified recipients. With respect to a government-established fund, proposed §1.897(l)-1(d)(12)(i)(A) defined a qualified recipient as any person eligible to be treated as a participant or beneficiary of such eligible fund and any person designated by such person to receive qualified benefits. Thus, the determination of whether a person was a qualified recipient of a government-established fund was made without regard to an individual’s

status as a current or former employee. With respect to an employer fund, proposed §1.897(l)-1(d)(12)(i)(B) defined a qualified recipient as a current or former employee or any person designated by such current or former employee to receive qualified benefits.

Several comments stated that the proposed regulations were too restrictive because they did not allow for the possible participation of individuals in an employer fund if they were neither current nor former employees, as allowed in some countries. The comments noted, however, that individuals who have never been employees represent only a minority of members in any fund. One comment suggested that the definition of qualified recipient be expanded accordingly to include any individual allowed to participate in an eligible fund under the laws of the foreign jurisdiction in which the fund is created or organized. Another comment requested that the definition of qualified recipient include a de minimis threshold for members of an eligible fund that are neither current nor former employees. For example, an eligible fund could qualify for the section 897(l) exemption (assuming all other requirements were met) if more than 70 percent of its members were current or former employees measured annually. The comment also recommended that spouses of eligible participants or beneficiaries should be explicitly identified as qualified recipients as defined in proposed §1.897(l)-1(d)(12).

Another comment stated that, as to government-established funds, the term qualified recipient could potentially be read as encompassing a broad group of participants in other types of government programs beyond just pension funds. The comment requested that the final regulations make explicit that a recipient (or person designating the recipient) must both have been employed and be receiving benefits by reason of his or her employment. Finally, one comment noted that the proposed regulations appropriately treated a self-employed individual as both an employer and an employee. Prop. §1.897(l)-1(c)(2)(ii)(C). The comment requested that proposed §1.897(l)-1(e), example 1, be altered to clarify that the retirement benefits provided under the facts of the example were provided as a

result of citizens' services as employed or self-employed individuals.

The Treasury Department and the IRS agree that the proposed regulations may unnecessarily restrict arrangements, permitted in certain countries, that allow for the participation of individuals who were never employees in an employer fund. Further, the Treasury Department and the IRS understand that such individuals represent only a minority of members in any fund. The Treasury Department and the IRS believe that unlimited or significant participation by individuals who were never employees or their designees would be inappropriate. The final regulations therefore allow individuals who were never employees to constitute up to five percent of participants in plans established by employers (and therefore to be treated as qualified recipients). §1.897(l)-1(e)(12)(i)(C). The final regulations also include spouses of current or former employees in the definition of qualified recipients. §1.897(l)-1(e)(12)(i)(B).

The Treasury Department and the IRS do not believe that further changes are necessary to (1) make explicit that a qualified recipient (or person designating the recipient) with respect to a government-established fund must both have been employed and be receiving benefits by reason of his or her employment, or (2) to modify proposed §1.897(l)-1(e), example 1, to state that the retirement and pension benefits provided by the government-established fund were provided as a result of citizens' services as employed or self-employed individuals. As provided in the proposed regulations, a government-established fund must be established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers, but may include participants on a basis broader than an employee relationship. The comments seeking to narrow the scope of qualified recipients for government-established funds are inconsistent with the request to broaden the definition of a qualified recipient with respect to an employer fund to include (within limits) individuals who were never employees. At the same time, the Treasury Department and the IRS believe that

an explicit connection between the work of an employee and the qualified benefits provided by an eligible fund is reflected in the final regulations through the definition of a government-established fund, as well as the requirement that all eligible funds must reasonably expect to provide 85 percent retirement and pension benefits, which are defined in the final regulations at §1.897(l)-1(e)(14). These requirements provide an appropriate safeguard to ensure that government programs other than retirement and pension programs do not form the basis for exemption from tax under section 897(l). Finally, the Treasury Department and the IRS believe that the rule reflected in §1.897(l)-1(c)(2)(ii)(E) (*J*) (previously at proposed §1.897(l)-1(c)(2)(ii)(C)(*J*)), which explicitly states that a self-employed individual is considered both an employer and employee, makes adding a reference to self-employed individuals in proposed §1.897(l)-1(e), example 1, unnecessary.

B. Regulation and information reporting

The proposed regulations provided that an eligible fund satisfies the information reporting requirement in section 897(l)(2)(D) only if the eligible fund annually provides to the relevant tax authorities in the foreign country in which the fund is established or operates the amount of qualified benefits provided to each qualified recipient by the eligible fund (if any), or such information is otherwise available to those authorities. Prop. §1.897(l)-1(c)(iv)(B). An eligible fund is not treated as failing to satisfy such requirement if the eligible fund is not required to provide information to the relevant tax authorities in a year in which no qualified benefits are provided to qualified recipients. *Id.* An eligible fund is also treated as satisfying the information reporting requirement in section 897(l)(2)(D) only if the eligible fund is required to provide the information required by proposed §1.897(l)-1(c)(iv)(B), or such information is otherwise available, to one or more governmental units. Prop. §1.897(l)-1(c)(iv)(C).

One comment highlighted that the rules in the proposed regulations are inadvertently inconsistent when an eligible fund is required by foreign law to provide information to a governmental unit (satis-

fying proposed §1.897(l)-1(c)(iv)(C)), but does not actually provide such information (not fulfilling proposed §1.897(l)-1(c)(iv)(B)), and requested that the final regulations clarify how these provisions are intended to work.

Proposed §1.897(l)-1(c)(iv)(B) and proposed §1.897(l)-1(c)(iv)(C) were not intended to function as two separate conditions that were required to be met. Rather, the provisions were intended to provide flexibility to eligible funds that provided the relevant information to tax authorities or other governmental units. To clarify this intent, the final regulations combine the two separate provisions into a single provision (§1.897(l)-1(c)(iv)(A)). Thus, the information reporting requirement in section 897(l)(2)(D) is satisfied if a fund annually provides information about the amount of qualified benefits provided to qualified recipients to the relevant tax authorities or other relevant governmental units, or such information is otherwise available to the relevant tax authorities or other relevant governmental units. §1.897(l)-1(c)(iv)(A). A fund will not fail to satisfy such requirement if it is not required to provide information to the relevant tax authorities or other relevant governmental units in a year in which no qualified benefits are provided to qualified recipients. *Id.*

C. Subnational tax regime

For purposes of the requirement that a QFPF be subject to preferential tax treatment, the proposed regulations provided that, for purposes of section 897(l)(2)(E), references to a foreign country do not include references to a state, province, or political subdivision of a foreign country. The preamble to the proposed regulations explained that subnational taxes generally constitute a minor component of an entity's overall tax burden in a foreign jurisdiction and therefore should not satisfy the requirement of section 897(l)(2)(E) when such preference had only a minimal impact on reducing the fund's overall tax burden.

Upon further consideration, the Treasury Department and the IRS have determined that, to the extent the subnational tax law is covered under an income tax treaty with the United States, it should

constitute a sufficient component of the foreign jurisdiction's taxation regime to be able to satisfy the requirement of section 897(l)(2)(E). Accordingly, the final regulations maintain the approach that subnational taxes generally do not satisfy the requirement of section 897(l)(2)(E), but provide that those taxes can satisfy the requirement of section 897(l)(2)(E) if they are covered taxes under an income tax treaty between that foreign jurisdiction and the United States. See §1.897(l)-1(c)(2)(v)(E).

III. Other Comments and Revisions

A. Withholding rules

1. Withholding on foreign partnerships

Comments requested that the final regulations allow QFPFs that hold interests in USRPIs through foreign partnerships, which are not qualified holders under proposed §1.897(l)-1(d)(11) because they cannot be QCEs, to avoid withholding by providing a certification of non-foreign status (including on a Form W-8EXP). The comments highlighted the difference in withholding when a QFPF invests through a foreign partnership, which would result in withholding (even if the foreign partnership was wholly owned by QFPFs), as opposed to through a foreign corporation that constitutes a QCE or a domestic partnership, neither of which would result in withholding under section 1445. One comment recommended that, for purposes of withholding under section 1445, the final regulations should implement rules similar to the regulations that implement the withholding regime under section 1446(f), which includes a form of look-through rule. Another comment recommended that the final regulations provide that a foreign partnership that is wholly owned by QFPFs either be treated as a QCE, and therefore a qualified holder, or otherwise be excluded from the definition of a foreign person under section 1445 such that a foreign partnership could certify its non-foreign status to a transferee.

The Treasury Department and the IRS agree that a foreign partnership that is held entirely by qualified holders should not be subject to withholding under section 1445

because the ultimate owners should qualify in full for the exemption under section 897(l). Accordingly, the final regulations provide that a qualified holder (under §1.897(l)-1(d)) and a foreign partnership all of the interests of which are held by qualified holders, including through one or more partnerships, may certify its status as a withholding qualified holder that is not treated as a foreign person for purposes of withholding under section 1445 (and section 1446, as relevant). §1.1445-1(g)(11). To the extent any non-qualified holders hold interests in a foreign partnership, such foreign partnership does not qualify as a withholding qualified holder. However, qualified holders who hold interests in USRPIs through a foreign partnership that is not a withholding qualified holder would still be eligible for the section 897(l) exemption on their distributive share of FIRPTA gains. Under the existing regulations in §1.1445-3, a transferor may, in appropriate cases, reduce withholding by obtaining a withholding certificate from the IRS.

2. Documentation requirements

The proposed regulations permitted a qualified holder to certify that it is exempt from withholding under section 1445 by providing a certification of non-foreign status. The proposed regulations also stated that the IRS intended to revise Form W-8EXP, "Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding or Reporting," to permit qualified holders to be exempt from withholding under section 1445 by establishing their status under section 897(l). Prop. §§1.1445-2(b)(2), 1.1445-2(b)(v), 1.1445-5(b)(3)(ii), and 1.1445-8(e).

Under the final regulations, a withholding qualified holder may submit a certification of non-foreign status to establish withholding qualified holder status for purposes of section 1445(a) pursuant to §1.1445-2(b)(2)(i), with certain modifications. Specifically, the requirements under §1.1445-2(b)(2)(i) are modified to require the transferor to state that it is not treated as a foreign person because it is a withholding qualified holder, and to permit the transferor to provide its foreign taxpayer identification number if it does

not have a U.S. taxpayer identification number. The final regulations also clarify that a Form W-8EXP is a type of certification of non-foreign status within the meaning of §1.1445-2(b)(2)(i). Accordingly, the Form W-8EXP is subject to the general rules pertaining to certifications of non-foreign status, such as the period for retaining the certification in §1.1445-2(b)(3) and the rules pertaining to liability of agents in §1.1445-4. Because the final regulations require a transferor to represent its status as a withholding qualified holder on the certification of non-foreign status, the final regulations do not permit a transferor to submit a Form W-9, “Request for Taxpayer Identification Number and Certification,” to establish its status as a withholding qualified holder. See §1.1445-2(b)(2)(vi). Before the release of revised Form W-8EXP, a certification of non-foreign status described in §1.1445-2(b)(2)(i) (but not a Form W-9) should be used by a transferor to establish its status as a withholding qualified holder for purposes of section 1445. Once revised, a withholding qualified holder may certify its non-foreign status with either a certification of non-foreign status described in §1.1445-2(b)(2)(i) (but not a Form W-9) or a Form W-8EXP.

The final regulations provide similar rules for certifications of non-foreign status that establish withholding qualified holder status for purposes of section 1445(e) withholding. See §§1.1445-5(b)(3)(ii) and 1.1445-8(e).

3. Coordination with 1441 and 1442

The proposed regulations provided that distributions made by a United States real property holding company (“USRPHC”) or qualified investment entity (“QIE”) to a qualified holder are not subject to the coordination rules under §1.1441-3(c)(4) and are instead subject only to the requirements of section 1441. Prop. §1.1441-3(c)(4)(iii). Because a qualified holder is treated as a foreign person for purposes of section 1441, but not for purposes of 1445, the proposed rule was intended to subject a distribution to a qualified holder exclusively to the rules in section 1441 to determine if withholding applies.

The Treasury Department and the IRS have determined that, for greater clarity,

certain changes should be made to proposed §1.1441-3(c)(4) to reach the result intended by the proposed regulations. Rather than provide that the coordination rules under §1.1441-3(c)(4) do not apply to qualified holders, the final regulations amend the coordination rules to provide that withholding qualified holders are not subject to section 1445 on distributions from USRPHCs that are not treated as dividends (for example, a distribution that is treated as gain from the sale or exchange of property under section 301(c)(3)) and on distributions from REITs or other QIEs that are capital gain dividends that are treated as gain attributable to the sale or exchange of USRPIs. §1.1441-3(c)(4)(i)(B)(2), §1.1441-3(c)(4)(i)(C). Dividends from USRPHCs and dividends from REITs or other QIEs that are not capital gain dividends continue to be subject to withholding under section 1441. §1.1441-3(c)(4)(i)(A), §1.1441-3(c)(4)(i)(C). Section 1.1441-3(c)(4)(i) is also clarified to provide that a USRPHC (other than a REIT or other QIE) satisfies its obligations under sections 1441 and 1445 by following either §1.1441-3(c)(4)(i)(A) or §1.1441-3(c)(4)(i)(B), but a USRPHC that is a REIT or other QIE must follow the coordination provision in §1.1441-3(c)(4)(i)(C). The final regulations also clarify that, to the extent a capital gain dividend from a REIT or other QIE is excluded from withholding under section 1445 because it is made with respect to stock that is regularly traded on an established securities market in the United States to an individual or corporation that did not own more than 5 percent of the stock (see the second sentence of section 897(h)(1)), withholding will apply under section 1441. See sections 852(b)(3)(E) and 857(b)(3)(E); §1.1441-3(c)(4)(i)(C).

B. Additional requests regarding qualification under section 897(l) and recordkeeping

Comments recommended that the Treasury Department and the IRS allow foreign entities that believe they are QFPFs or QCEs to apply for letter rulings on their qualifications under section 897(l). While the comment acknowledged the need for administrable standards, it noted that, in light of the wide range of possible

arrangements under foreign law, certain funds that a “reasonable observer” would consider a QFPF could be excluded. Another comment recommended that the Treasury Department and the IRS adopt a “white list” regime (similar to the United Kingdom’s Qualifying Recognized Overseas Pension Scheme) whereby pension plan regimes regulated in a list of countries could automatically be treated as QFPFs or be subject to a reduced set of qualifying requirements.

The final regulations do not adopt either of these recommendations. The Treasury Department and the IRS do not believe that a private letter ruling program specific to QFPF qualification or a “white list” regime is necessary, as the final regulations provide flexible standards such that a wide variety of funds can constitute eligible funds.

Another comment requested that the final regulations provide that, to the extent life insurance companies or other investment companies hold and invest assets of one or more QFPFs, those life insurance companies or investment companies themselves should qualify as QFPFs. To qualify as a QFPF, an eligible fund must satisfy all of the requirements in §1.897(l)-1(c)(2), and the final regulations do not adopt any special rule for life insurance companies or investment companies, including whether such assets are held as part of an arrangement comprising a QFPF.

In addition, the final regulations require an eligible fund to maintain records consistent with section 6001 to show that it is eligible for the exemption under section 897(l) and which the Commissioner may request upon examination. The recordkeeping requirement is consistent with general recordkeeping requirements for U.S. taxpayers and is appropriate in light of the flexible standards provided in the final regulations.

C. Clarification with respect to the applicability of the section 897(l) regulations

These regulations reflect the particular policies and objectives underlying section 897(l) (as opposed to other areas of tax law that relate to pension funds). To clarify this, §1.897(l)-1(a) provides that the definitions and requirements in §1.897(l)-

l apply only for purposes of the regulations themselves, including applicable cross-references from other sections, and that no inference is to be drawn with respect to the definitions and requirements in §1.897(l)-1, including with respect to the meaning of a pension fund, for any other purpose.

IV. *Applicability Dates*

The final regulations apply with respect to dispositions of USRPIs and distributions described in section 897(h) occurring on or after December 29, 2022. However, in accordance with the applicability date incorporated in §1.897(l)-1(g)(2), the rule in §1.897(l)-1(b)(1), the qualified holder rule in §1.897(l)-1(d) (previously proposed §1.897(l)-1(d)(11)), as well as the definitions of governmental unit (§1.897(l)-1(e)(5)) and QCE (§1.897(l)-1(e)(9)) apply with respect to dispositions of USRPIs and distributions described in section 897(h) occurring on or after June 6, 2019, the date the proposed regulations were filed with the **Federal Register**. See section 7805(b)(1)(B). An eligible fund may choose to apply the final regulations with respect to dispositions and distributions occurring on or after December 18, 2015, and before the applicability date of the final regulations, if the eligible fund, and all persons bearing a relationship to the eligible fund described in section 267(b) or 707(b), consistently apply the rules in the final regulations in their entirety for all relevant years. An eligible fund that chooses to apply the final regulations before their applicability date must apply the principles of §1.897(l)-1(d)(4)(i) to any valuation requirements with respect to dates preceding December 18, 2015.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

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.

II. *Paperwork Reduction Act*

In accordance with the Paperwork Reduction Act, 44 U.S.C. 3501 *et seq.* (“PRA”), information collection requirements contained in these final regulations are in §§1.1441-3, 1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1. These collections of information retain the collections of information in the proposed regulations, with a refinement to §1.1441-3(c)(4) to clarify that the portions of distributions made by a USRPHC or QIE to a withholding qualified holder (as defined in §1.1445-1(g)(11)) that are attributable to the disposition of USRPIs are not subject to section 1445 and that the portions of distributions made by a USRPHC or QIE to a withholding qualified holder that are not attributable to the disposition of a USRPI are subject to section 1441. No written comments regarding the information collection requirements were received in response to the solicitation of comments in the proposed regulations.

A. Information collections contained in §1.1441-3(c)(4)(iii)

The final regulations provide that dividends from a USRPHC and dividends from REITs and other QIEs that are not capital gain dividends to a withholding qualified holder are subject only to the requirements of section 1441. §1.1441-3(c)(4)(i), §1.1441-3(c)(4)(i)(B)(2), §1.1441-3(c)(4)(i)(C). The final regulations further provide that withholding qualified holders are not subject to section 1445 on distributions from USRPHCs that are not treated as dividends (for example, a distribution that is treated as gain from the sale or exchange of property under section 301(c)(3)) and on distributions from REITs or QIEs that are capital gain dividends that are treated as gain attributable to the sale or exchange of USRPIs. §1.1441-3(c)(4)(i)(B)(2), §1.1441-3(c)(4)(i)(C).

A USRPHC or QIE making a distribution to a qualified holder would be required to report the distribution on Form 1042-S, “Foreign Person’s U.S. Source Income Subject to Withholding,” and file Form 1042, “Annual Withholding Tax Return for U.S. Source Income of For-

eign Persons.” For purposes of reporting the portion of the distributions that are exempt from section 1445 withholding, the IRS revised Form 1042-S to include an exemption code designating payments that are exempt under section 897(l). No revisions are being made to Form 1042 in connection with payments that are exempt under section 897(l).

For purposes of the PRA, the reporting burden associated with §1.1441-3(c)(4) will be reflected in the PRA submissions for Form 1042 (OMB control numbers 1545-0123 for business filers and 1545-0096 for all other Form 1042 filers) and Form 1042-S (OMB control number 1545-0096).

B. Information collections in §§1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1

Sections 1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1 would require a qualified holder wishing to claim an exemption under section 897(l) to provide a withholding agent with either a Form W-8EXP or a certificate of non-foreign status containing similar information to the Form W-8EXP. The IRS plans to revise Form W-8EXP for use by qualified holders. For purposes of the PRA, the reporting burden associated with §§1.1445-2, 1.1445-5, 1.1445-8, and 1.1446-1, will be reflected in the PRA submission for Form W-8EXP (OMB control number 1545-1621).

The reporting burdens associated with the information collections in the final regulations are included in the aggregate burden estimates for OMB control numbers 1545-0096 (which represents a total estimated burden time for all forms and schedules of 6.46 million hours) and 1545-1621 (which represents a total estimated burden time, including all other related forms and schedules for other filers, of 30.5 million hours). The overall burden estimates for the OMB control numbers are aggregate amounts that relate to the entire package of forms associated with the applicable OMB control number and will in the future include, but not isolate, the estimated burden of the tax forms that will be or have been 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. These burdens have been reported for other regulations related to the taxation of cross-border income, and the Treasury Department and the IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions impose.

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.

III. *Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), 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. This certification is based on the fact that the final regulations affect foreign pension funds, including sovereign funds, which are entities that are created or organized outside of the United States, with no place of business in the United States, and which operate primarily outside of the United States. Accordingly, the entities affected by the final regulations are not considered small entities, and a regulatory flexibility analysis under the Regulatory Flexibility Act is not required.

IV. *Section 7805(f)*

Pursuant to section 7805(f) of the Code, the proposed regulations (REG-109826-17) 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.

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.

VI. *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, do not impose substantial direct compliance costs on state and local governments, and do not preempt state law within the meaning of the Executive order.

Statement of Availability of IRS Documents

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

Drafting Information

The principal authors of these final regulations are Arielle Borsos and Milton Cahn, 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.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.897(l)-1 also issued under 26 U.S.C. 897(l).
* * * * *

Par. 2. Section 1.897(l)-1 is added to read as follows:

§1.897(l)-1 Exception for interests held by foreign pension funds.

(a) *Scope and overview.* This section provides rules regarding the exception from section 897 for qualified holders. The definitions and requirements in this section apply only for purposes of this section (including as applicable by cross-reference from other sections), and no inference is to be drawn with respect to the definitions and requirements in this section, including with respect to the meaning of a pension fund, for any other purpose. Paragraph (b) of this section provides the general rule excepting qualified holders from section 897. Paragraph (c) of this section provides the requirements that an eligible fund must satisfy to be treated as a qualified foreign pension fund. Paragraph (d) of this section provides the requirements that a qualified foreign pension fund or a qualified controlled entity must satisfy to be treated as a qualified holder. Paragraph (e) of this section provides definitions. Paragraph (f) of this section provides examples illustrating the application of the rules of this section. Paragraph (g) of this section provides applicability dates. For rules applicable to a qualified foreign pension fund or qualified controlled entity claiming an exemption from withholding under chapter 3, see generally §§1.1441-3, 1.1445-2, 1.1445-5, 1.1445-8, 1.1446-1, and 1.1446-2.

(b) *Exception from section 897—(1) In general.* Gain or loss of a qualified holder from the disposition of a United States real property interest, including gain from a distribution described in section 897(h), is not subject to section 897(a).

(2) *Limitation.* Paragraph (b)(1) of this section applies solely with respect to gain

or loss that is attributable to one or more qualified segregated accounts maintained by a qualified holder.

(c) *Qualified foreign pension fund requirements*—(1) *In general.* An eligible fund is a qualified foreign pension fund if it satisfies the requirements of this paragraph (c). Paragraph (c)(2) of this section provides rules regarding the application of the requirements of section 897(l)(2) to an eligible fund. Paragraph (c)(3) of this section provides rules on the application of the requirements in paragraph (c)(2) of this section, including rules regarding the application of those requirements to an eligible fund that is an organization or arrangement and rules regarding record-keeping.

(2) *Applicable requirements*—(i) *Created or organized.* An eligible fund must be created, organized, or established under the laws of a foreign jurisdiction. For purposes of this paragraph (c)(2)(i), a governmental unit is treated as created or organized in the foreign jurisdiction with respect to which it is, or is a part of, the foreign government.

(ii) *Establishment of eligible fund*—(A) *General requirement*—(1) *Purpose of and parties establishing eligible fund.* An eligible fund must be established—

(i) By, or at the direction of, the foreign jurisdiction in which it is created or organized to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers; or

(ii) By one or more employers (including a governmental unit in its capacity as an employer) to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees in consideration for services rendered by such employees to such employers.

(2) *Identification of type of eligible fund.* An eligible fund that is described in both paragraphs (c)(2)(ii)(A)(1)(i) and (ii) of this section shall be treated solely as described in the latter paragraph.

(3) *Role of parties other than the foreign jurisdiction or employer.* For purposes of paragraph (c)(2)(ii)(A)(1) of this section, the determination of whether an

eligible fund is established by, or at the direction of, a foreign jurisdiction or established by an employer is made without regard to whether one or more persons that are not the foreign jurisdiction or employer administer or otherwise provide services with regard to the eligible fund (including holding assets in a qualified segregated account as part of or on behalf of the eligible fund).

(B) *Established to provide retirement or pension benefits.* An eligible fund is established to provide retirement or pension benefits for purposes of the general requirement in paragraph (c)(2)(ii)(A) of this section if—

(1) All of the benefits that an eligible fund provides are qualified benefits provided to qualified recipients;

(2) At least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide to qualified recipients in the future are retirement and pension benefits; and

(3) No more than five percent of the present value of the qualified benefits the eligible fund reasonably expects to provide to qualified recipients in the future are non-ancillary benefits.

(C) *Present valuation.*—(1) *In general.* For purposes of satisfying the requirements in paragraphs (c)(2)(ii)(B)(2) and (3) of this section, an eligible fund must determine, on at least an annual basis, the present value of the qualified benefits that the eligible fund reasonably expects to provide to qualified recipients during the entire period during which the eligible fund is expected to be in existence. An eligible fund may utilize any reasonable method for performing the present valuation.

(2) *48-month average alternative calculation.* An eligible fund that does not satisfy the requirements of paragraph (c)(2)(ii)(B)(2) or (3) of this section based on the present value determination under paragraph (c)(2)(ii)(C)(1) of this section may satisfy the requirements of paragraph (c)(2)(ii)(B)(2) or (3) of this section based on the alternative calculation in this paragraph (c)(2)(ii)(C)(2). The alternative calculation in this paragraph is satisfied if the average of the present values of the future qualified benefits that the eligible fund reasonably expects to provide, as determined during the 48-month period

preceding (and including) the most recent present valuation determination, satisfies the requirements of paragraph (c)(2)(ii)(B)(2) or (3) of this section, respectively. The determination of such average must be based on the valuations described in paragraph (c)(2)(ii)(C)(1) of this section that were carried out during the 48-month period preceding (and including) the most recent present value determination, and must use the values (not percentages) of the qualified benefits the eligible fund reasonably expects to provide. The determination described in this paragraph must be calculated using a weighted average whereby values are adjusted if the relevant valuations are applicable for different periods (as described in paragraph (c)(2)(ii)(C)(3) of this section) because an eligible fund performs valuations more frequently than on an annual basis. If an eligible fund has been in existence for less than 48 months, this paragraph (c)(2)(ii)(C)(2) is applied to the period that the eligible fund has been in existence. The alternative calculation in this paragraph (c)(2)(ii)(C)(2) may be satisfied based on any reasonable determination of the present valuation described in paragraph (c)(2)(ii)(C)(1) of this section for any period that starts before the date that the requirements of paragraph (c)(2)(ii)(C) of this section first apply to an organization or arrangement and ends on or before December 29, 2022.

(3) *Application of present valuation.* An eligible fund must use the present value determination made as of the most recent valuation under paragraph (c)(2)(ii)(C)(1) of this section or the alternative calculation provided in paragraph (c)(2)(ii)(C)(2) of this section (to the extent the eligible fund did not satisfy the requirements of paragraphs (c)(2)(ii)(B)(2) and (3) of this section in the most recent valuation) for purposes of meeting the requirements in paragraphs (c)(2)(ii)(B)(2) and (3) of this section with respect to dispositions of United States real property interests or distributions described in section 897(h) occurring in the twelve months succeeding the most recent valuation, or until a new present value determination is made, whichever occurs first.

(D) *Certain distributions from eligible funds.* The following distributions are not taken into account for purposes of deter-

mining whether an eligible fund satisfies the requirements of paragraph (c)(2)(ii)(B) of this section—

(1) A loan to a qualified recipient pursuant to terms set by the eligible fund (other than a loan with respect to which a qualified recipient defaults and is not required to repay in whole or part, unless the default is subject to tax and penalty in such foreign jurisdiction);

(2) A distribution (as permitted by the laws of the foreign jurisdiction in which the eligible fund is established or operates) made before the participant or beneficiary reaches the retirement age (as determined under the relevant foreign laws), provided that the distribution is to a designee that is a qualified holder or to another arrangement subject to similar distribution or tax rules under the laws of the foreign jurisdiction; and

(3) A withdrawal of funds before the participant or beneficiary reaches the retirement age (as determined under the relevant foreign laws) to satisfy a financial need (under principles similar to the U.S. hardship distribution rules, see §1.401(k)-1(d)(3)) as permitted under the laws of the foreign jurisdiction in which the eligible fund is established or operates, provided the distribution (or at least the portion of the distribution exceeding basis) is subject to tax and penalty in such foreign jurisdiction.

(E) *Certain employers and employees.* For purposes of this section, the following rules apply—

(1) A self-employed individual is treated as both an employer and an employee;

(2) Employees of an individual, trust, corporation, or partnership that is a member of an employer group are treated as employees of each member of the employer group that includes the individual, trust, corporation, or partnership; and

(3) An eligible fund established by a trade union, professional association, or similar group, either alone or in combination with the employer or group of employers, is treated as established by any employer that funds, in whole or in part, the eligible fund.

(iii) *Single participant or beneficiary—*
(A) *In general.* An eligible fund may not have a single qualified recipient that has a right to more than five percent of the assets or income of the eligible fund.

(B) *Constructive ownership.* For purposes of paragraph (c)(2)(iii)(A) of this section, an individual is considered to have a right to the assets or income of an eligible fund to which any person who bears a relationship to the individual described in section 267(b) or 707(b) has a right.

(iv) *Regulation and information reporting—*
(A) *In general.* The eligible fund must be subject to government regulation and annually provide to the relevant tax authorities (or other relevant governmental units) in the foreign jurisdiction in which the eligible fund is established or operates information about the amount of qualified benefits (if any) provided to each qualified recipient by the eligible fund, or such information must otherwise be available to the relevant tax authorities (or other relevant governmental units). An eligible fund is not treated as failing to satisfy the requirement of this paragraph (c)(2)(iv)(A) as a result of the eligible fund not being required to provide information to the relevant tax authorities (or other relevant governmental units) in a year in which no qualified benefits are provided to qualified recipients.

(B) *Treatment of certain eligible funds established by foreign jurisdictions.* An eligible fund that is described in paragraph (c)(2)(ii)(A)(1)(i) of this section is deemed to satisfy the requirements of paragraph (c)(2)(iv)(A) of this section.

(v) *Tax treatment—*
(A) *In general.* The tax laws of the foreign jurisdiction in which the eligible fund is established or operates must provide that, due to the status of the eligible fund as a retirement or pension fund, either—

(1) Contributions to the eligible fund that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of the eligible fund or taxed at a reduced rate; or

(2) Taxation of any investment income of the eligible fund is deferred or excluded from the gross income of the eligible fund or such income is taxed at a reduced rate.

(B) *Income subject to preferential tax treatment.* An eligible fund is treated as satisfying the requirement of paragraph (c)(2)(v)(A) of this section in a taxable year if, under the tax laws of the foreign jurisdiction in which the eligible fund is established or operates—

(1) At least 85 percent of the contributions to the eligible fund are subject to the tax treatment described in paragraph (c)(2)(v)(A)(1) of this section, or

(2) At least 85 percent of the investment income of the eligible fund is subject to the tax treatment described in paragraph (c)(2)(v)(A)(2) of this section.

(C) *Income not subject to tax.* An eligible fund is treated as satisfying the requirement of paragraph (c)(2)(v)(A) of this section if the eligible fund is exempt from the income tax of the foreign jurisdiction in which it is established or operates or the foreign jurisdiction in which it is established or operates has no income tax.

(D) *Other preferential tax regimes.* An eligible fund that does not receive the tax treatment described in either paragraph (c)(2)(v)(A)(1) or (2) of this section is nonetheless treated as satisfying the requirement of paragraph (c)(2)(v)(A) of this section if the eligible fund establishes that each of the conditions described in paragraphs (c)(2)(v)(D)(1) and (2) of this section is satisfied:

(1) Under the tax laws of the foreign jurisdiction in which the eligible fund is established or operates, the eligible fund is subject to a preferential tax regime due to its status as a retirement or pension fund; and

(2) The preferential tax regime described in paragraph (c)(2)(v)(D)(1) of this section has a substantially similar effect as the tax treatment described in paragraphs (c)(2)(v)(A)(1) or (2) of this section.

(E) *Tax law of subnational jurisdictions.* Solely for purposes of this paragraph (c)(2)(v), a reference to the tax law of a foreign jurisdiction includes the tax law of a political subdivision or other local authority of a foreign jurisdiction, provided that income taxes imposed under the subnational tax law are treated as covered taxes under an income tax treaty between that foreign jurisdiction and the United States.

(3) *Operating rules—*
(i) *Rules on the application of the requirements in paragraph (c)(2) of this section—*
(A) *Organizations or arrangements.* An organization or arrangement is treated as a single entity for purposes of determining whether the requirements of paragraph (c)(2) of this

section are satisfied, except that each person or governmental unit that is part of or party to an organization or arrangement must satisfy the requirement of paragraph (c)(2)(i) of this section.

(B) *Relevant income, assets, and functions.* The determination of whether an eligible fund satisfies the requirements of paragraph (c)(2) of this section is made solely with respect to the assets and income of the eligible fund held in one or more qualified segregated accounts, the qualified benefits funded by the qualified segregated accounts, the information reporting and regulation related to the qualified segregated accounts, and the qualified recipients whose benefits are funded by the qualified segregated accounts. For this purpose, all assets held by an eligible fund in qualified segregated accounts (within the meaning of paragraph (e)(13)(ii) of this section) are treated as a single qualified segregated account.

(ii) *Aggregate approach to partnerships.* For purposes of this section, assets held by a partnership shall be treated as held proportionately by its partners, and activities conducted by a partnership shall be treated as conducted by its partners.

(iii) *Recordkeeping.* An eligible fund that claims the exemption under section 897(l) must have records sufficient to establish that it satisfies the requirements of paragraph (c)(2) of this section. See section 6001 and §1.6001-1, requiring records to be maintained.

(d) *Qualified holder requirements—*
(1) *In general.* With respect to a disposition described in section 897(a) or a distribution described in section 897(h), a qualified foreign pension fund (including a part of a qualified foreign pension fund) or a qualified controlled entity is a qualified holder only if it satisfies the requirement of paragraph (d)(2) or (3) of this section.

(2) *Qualified holders that did not hold U.S. real property interests.* The requirement of this paragraph (d)(2) is satisfied if the qualified foreign pension fund or qualified controlled entity owned no United States real property interests as of the earliest date during an uninterrupted period, ending on the date of the disposition or distribution, in which the qualified foreign pension fund or qualified controlled entity satisfied the requirements of paragraph (c)

(2) of this section or paragraph (e)(9) of this section, as applicable.

(3) *Qualified holders that satisfy the testing period—*(i) *In general.* The requirement of this paragraph (d)(3) is satisfied if the qualified foreign pension fund or qualified controlled entity continuously satisfies the requirements of paragraph (c)(2) of this section or paragraph (e)(9) of this section, as applicable, for the duration of the testing period.

(ii) *Testing Period.* The term testing period means whichever of the following periods is the shortest:

(A) The period beginning on December 18, 2015, and ending on the date of the disposition or the distribution;

(B) The ten-year period ending on the date of the disposition or the distribution; and,

(C) The period beginning on the date the entity (or its predecessor) was created or organized and ending on the date of the disposition or the distribution.

(4) *Transition Rules—*(i) *Qualified foreign pension fund or qualified controlled entity requirements.* With respect to any period from December 18, 2015, to the date when the requirements of paragraph (c)(2) or (e)(9) of this section first apply to a qualified foreign pension fund or qualified controlled entity under paragraph (g) of this section, as applicable (but in any event no later than December 29, 2022, in the case of paragraph (c)(2) of this section, and no later than June 6, 2019, in the case of paragraph (e)(9) of this section), the qualified foreign pension fund or qualified controlled entity is deemed to satisfy the requirements of paragraphs (c)(2) and (e)(9) of this section, as applicable, for purposes of paragraphs (d)(2) and (3) of this section if the qualified foreign pension fund or qualified controlled entity satisfies the requirements of section 897(l)(2) based on a reasonable interpretation of those requirements (including determining any applicable valuations using a consistent method).

(ii) *Ownership of qualified controlled entity by service providers.* Solely for purposes of paragraphs (d)(2) and (3) of this section, the determination of whether a corporation or trust is a qualified controlled entity will not include stock or interests held directly or indirectly by any person that provides services to such cor-

poration or trust, provided that such stock or interests are, in the aggregate, no more than five percent (by vote or value) of the stock or interests of such corporation or trust. This paragraph (d)(4)(ii) applies to interests held from December 18, 2015 until February 27, 2023.

(e) *Definitions.* The following definitions apply for purposes of this section.

(1) *Ancillary benefits—*(i) *In general.* The term *ancillary benefits* means—

(A) Benefits payable upon the diagnosis of a terminal illness, incidental death benefits (for example, funeral expenses), short-term disability benefits, life insurance benefits, and medical benefits;

(B) Unemployment, shutdown, or lay-off benefits that do not continue past retirement age and do not affect the payment of accrued retirement and pension benefits; and

(C) Other health-related or unemployment benefits that are similar to the benefits described in paragraphs (e)(1)(i) and (ii) of this section.

(ii) *Overlap with retirement and pension benefits.* Ancillary benefits do not include any benefits that could also be defined as retirement and pension benefits within the meaning of paragraph (e)(14) of this section.

(2) *Eligible fund.* The term *eligible fund* means a trust, corporation, or other organization or arrangement that maintains one or more qualified segregated accounts.

(3) *Employer group.* The term *employer group* means all individuals, trusts, partnerships, and corporations with a relationship to each other specified in section 267(b) or section 707(b).

(4) *Foreign jurisdiction.* The term *foreign jurisdiction* means a jurisdiction other than the United States, including a country, a state, province, or political subdivision of a foreign country, and a territory of the United States.

(5) *Governmental unit.* The term *governmental unit* means any foreign government or part thereof, including any person, body, group of persons, organization, agency, bureau, fund, or instrumentality, however designated, of a foreign government.

(6) *Non-ancillary benefits.* The term *non-ancillary benefits* means benefits that are neither ancillary benefits (within the

meaning of paragraph (e)(1) of this section) nor retirement and pension benefits (within the meaning of paragraph (e)(14) of this section), and are provided by the eligible fund as permitted or required under the laws of the foreign jurisdiction in which the eligible fund is established or operates.

(7) *Organization or arrangement.* The term *organization or arrangement* means one or more trusts, corporations, governmental units, or employers.

(8) *Qualified benefits.* The term *qualified benefits* means retirement and pension benefits, ancillary benefits and non-ancillary benefits. However, the portions of qualified benefits consisting of ancillary benefits and non-ancillary benefits provided by a qualified foreign pension fund are limited as provided in paragraph (c)(2)(ii)(B) of this section.

(9) *Qualified controlled entity.* The term *qualified controlled entity* means a trust or corporation created or organized under the laws of a foreign jurisdiction all of the interests of which are held by one or more qualified foreign pension funds directly or indirectly through one or more qualified controlled entities.

(10) *Qualified foreign pension fund.* The term *qualified foreign pension fund* means an eligible fund that satisfies the requirements of paragraph (c) of this section.

(11) *Qualified holder.* The term *qualified holder* means a qualified foreign pension fund or qualified controlled entity that satisfies the requirements of paragraph (d) of this section.

(12) *Qualified recipient*—(i) *In general.* The term *qualified recipient* means—

(A) With respect to an eligible fund described in paragraph (c)(2)(ii)(A)(I)(i) of this section, any person eligible to be treated as a participant or beneficiary of such eligible fund and any person designated by such participant or beneficiary to receive qualified benefits, and

(B) With respect to an eligible fund described in paragraph (c)(2)(ii)(A)(I)(ii) of this section, a current or former employee, a spouse of a current or former employee, and any person designated by such participants or beneficiaries to receive qualified benefits.

(C) To the extent not already described in paragraph (e)(12)(i)(B) of this section,

with respect to an eligible fund described in paragraph (c)(2)(ii)(A)(I)(ii) of this section, any person eligible to be treated as a participant or beneficiary of such fund and any person designated by such participant or beneficiary to receive qualified benefits, so long as such recipients do not exceed five percent of the eligible fund's total qualified recipients or have a right to more than five percent of the assets or income of the eligible fund. An eligible fund must make a determination for purposes of this paragraph (e)(12)(i)(C) on at least an annual basis and may utilize any reasonable method in doing so. An eligible fund must use its most recent determination under this paragraph with respect to dispositions of United States real property interests or distributions described in section 897(h) occurring in the twelve months succeeding such determination, or until a new determination is made, whichever occurs first.

(ii) *Special rule regarding automatic designation.* For purposes of paragraph (e)(12)(i) of this section, a person is treated as designating another person to receive qualified benefits if the other person is, by reason of such person's relationship or other status with respect to the first person, entitled to receive benefits pursuant to the terms applicable to the eligible fund or pursuant to the laws of the foreign jurisdiction in which the eligible fund is created or organized, whether or not the first person expressly designated such person as a beneficiary.

(13) *Qualified segregated account*—(i) *In general.* The term *qualified segregated account* means an identifiable pool of assets maintained by an eligible fund or a qualified controlled entity for the sole purpose of funding and providing qualified benefits to qualified recipients.

(ii) *Assets held by eligible funds.* For purposes of paragraph (e)(13)(i) of this section, an identifiable pool of assets of an eligible fund is treated as maintained for the sole purpose of funding qualified benefits to qualified recipients, and hence as a qualified segregated account, only if the terms applicable to the eligible fund or the laws of the foreign jurisdiction in which the eligible fund is established or operates require that all the assets in the pool, and all the income earned with respect to such assets, be used exclusively

to fund the provision of qualified benefits to qualified recipients or to satisfy necessary reasonable expenses of the eligible fund, and that such assets or income may not inure to the benefit of a person other than a qualified recipient. For purposes of this paragraph (e)(13)(ii), the fact that assets or income may inure to the benefit of a governmental unit by operation of escheat or similar laws, or may revert (such as upon plan termination or dissolution (after all obligations to qualified recipients and creditors have been satisfied) or the qualified recipients' benefits failing to vest) to the governmental unit or employer in accordance with applicable foreign law is ignored, so long as contributions to the plan are not more than reasonably necessary to fund the qualified benefits to be provided to qualified recipients.

(iii) *Assets held by qualified controlled entities.* For purposes of paragraph (e)(13)(i) of this section, the assets of a qualified controlled entity are treated as an identifiable pool of assets maintained for the sole purpose of funding qualified benefits to qualified recipients only if both of the following requirements are satisfied:

(A) All of the net earnings of the qualified controlled entity are credited to its own account or to the qualified segregated account of a qualified foreign pension fund or another qualified controlled entity, with no portion of the net earnings of the qualified controlled entity inuring to the benefit of a person other than a qualified recipient; and

(B) Upon dissolution, all of the assets of the qualified controlled entity, after satisfaction of liabilities to persons having interests in the entity solely as creditors, vest in a qualified segregated account of a qualified foreign pension fund or another qualified controlled entity.

(14) *Retirement and pension benefits.* The term *retirement and pension benefits* means distributions to qualified recipients that are made after the qualified recipient reaches retirement age as determined under or in accordance with the laws in the foreign jurisdiction in which the eligible fund is established or operates (including a benefit paid to a qualified recipient who retires on or after a stated early retirement age), or after a specified event that results in a qualified recipient being permanently unable to work, and includes any such

distribution made to a surviving beneficiary of the qualifying recipient. Retirement and pension benefits may be based on one or more of the following factors: contributions, investment performance, years of service with an employer, or compensation received by the qualified recipient.

(f) *Examples.* This paragraph (f) provides examples that illustrate the rules of this section. The examples do not illustrate the application of the applicable withholding rules, including sections 1445 and 1446 and the regulations thereunder. It is assumed that no person is entitled to more than five percent of any eligible fund's assets or income, taking into account the constructive ownership rules in paragraph (c)(2)(iii)(B) of this section, and that the eligible fund owns no United States real property interests other than as described.

(1) *Example 1: No legal entity—(i) Facts.* On January 1, 2023, Country A establishes Retirement Plan for the sole purpose of providing retirement and pension benefits to citizens of Country A aged 65 or older. Retirement Plan is composed of Asset Pool and Agency. Asset Pool is a group of accounts maintained on the balance sheet of the government of Country A. Pursuant to the laws of Country A, income and gain earned by Asset Pool is used solely to support the provision of retirement and pension benefits by Retirement Plan. Agency is a Country A agency that administers the provision of benefits by Retirement Plan and manages Asset Pool's investments. Under the laws of Country A, investment income earned by Retirement Plan is not subject to Country A's income tax. At the end of each calendar year, Retirement Plan performs a present valuation of the retirement and pension benefits it reasonably expects to provide in the future, and all of the benefits that Retirement Plan reasonably expects to provide are retirement and pension benefits. On January 1, 2024, Agency purchases Property, which is an interest in real property located in the United States owned by Asset Pool. On June 1, 2026, Agency sells Property, realizing \$100x of gain with respect to Property that would be subject to tax under section 897(a) unless paragraph (b) of this section applies with respect to the gain.

(ii) *Analysis.* (A) Retirement Plan, which is composed of Asset Pool and Agency, includes one or more governmental units described in paragraph (e)(5) of this section. Accordingly, Retirement Plan is an organization or arrangement described in paragraph (e)(7) of this section. Furthermore, Retirement Plan maintains a qualified segregated account in the form of Asset Pool, an identifiable pool of assets maintained for the sole purpose of funding retirement and pension benefits to beneficiaries of the Retirement Fund (qualified recipients as defined in paragraph (e)(12)(i)(A) of this section). Therefore, Retirement Plan is an eligible fund within the meaning of paragraph (e)(2) of this section.

(B) Paragraph (c)(3)(i) of this section applies for purposes of determining whether Retirement Plan

is an eligible fund that satisfies the requirements of paragraph (c)(2) of this section and would therefore be treated as a qualified foreign pension fund. Accordingly, the activities of Asset Pool and Agency are integrated and treated as undertaken by a single entity to determine whether the requirements of paragraph (c)(2) of this section are met. However, Asset Pool and Agency must independently satisfy the requirement of paragraph (c)(2)(i) of this section.

(C) Retirement Plan is composed of Asset Pool and Agency, each of which is a governmental unit and treated as created or organized under the laws of Country A for purposes of paragraph (c)(2)(i) of this section. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(i) of this section.

(D) Retirement Plan is established by Country A as an eligible fund described in paragraph (c)(2)(ii)(A)(I)(i) of this section to provide retirement and pension benefits, which are qualified benefits described in paragraph (e)(8) of this section, to citizens of Country A, who are qualified recipients described in paragraph (e)(12)(i)(A) of this section because they are eligible to be participants or beneficiaries of Retirement Plan. Accordingly, all of the benefits that Retirement Plan provides are qualified benefits provided to qualified recipients. In addition, Retirement Plan satisfies the requirements of the present valuation test as described in paragraphs (c)(2)(ii)(B) and (C) of this section. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(ii) of this section.

(E) Retirement Plan provides retirement and pension benefits to citizens of Country A aged 65 or older, with no citizen entitled to more than five percent of Retirement Fund's assets or to more than five percent of the income of the eligible fund. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(iii) of this section.

(F) Retirement Plan is composed solely of governmental units within the meaning of paragraph (e)(5) of this section. Accordingly, under paragraph (c)(2)(iv)(B) of this section, Retirement Plan is treated as satisfying the requirements of paragraph (c)(2)(iv)(A) of this section.

(G) Investment income earned by Retirement Plan is not subject to income tax in Country A. Accordingly, Retirement Plan satisfies the requirement of paragraph (c)(2)(v) of this section.

(H) Because Retirement Plan satisfies the requirements of paragraph (c)(2) of this section, Retirement Plan is a qualified foreign pension fund. Because Retirement Plan held no United States real property interests as of January 1, 2023, the earliest date during an uninterrupted period ending on June 1, 2026, the date of the disposition, in which it satisfied the requirements of paragraph (c)(2) of this section, Retirement Plan is a qualified holder under paragraph (d)(2) of this section. Retirement Plan's gain with respect to Property is attributable solely to Asset Pool, a qualified segregated account maintained by Retirement Plan. Accordingly, under paragraph (b) of this section, the \$100x gain realized by Retirement Plan attributable to the disposition of Property is not subject to section 897(a).

(2) *Example 2: Fund established by an employer—(i) Facts.* Employer, a corporation organized in Country B, establishes Fund to provide retirement and pension benefits to current and former employ-

ees of Employer and S1, a Country B corporation that is wholly owned by Employer. On January 1, 2023, Fund is established as a trust under the laws of Country B, and Employer retains discretion to invest assets and to administer benefits on Fund's behalf. Fund receives contributions from Employer and S1 and contributions from employees of Employer and S1 who are beneficiaries of Fund. All contributions to Fund and all of Fund's earnings are separately accounted for on Fund's books and records and are required by Fund's organizational documents to exclusively fund the provision of benefits to Fund's beneficiaries, except as necessary to satisfy reasonable expenses of Fund. Fund currently has over 100 beneficiaries, a number that is reasonably expected to grow as Employer expands. Fund will pay benefits to employees upon retirement based on years of service and employee contributions, but, if a beneficiary dies before retirement, Fund will pay an incidental death benefit in addition to payment of any accrued retirement and pension benefits to the beneficiary's designee (or deemed designee under local laws if the beneficiary fails to identify a designee). Fund annually performs a present valuation of the benefits it reasonably expects to provide to Fund's beneficiaries, and the valuation concludes that more than 85 percent of the present value of the total benefits it reasonably expects to pay to its beneficiaries in the future are retirement and pension benefits. In addition, it is reasonably expected that the incidental death benefits paid by Fund will account for less than fifteen percent of the present value of the total benefits that Fund expects to provide in the future, and Fund does not reasonably expect to pay any other types of benefits to its beneficiaries in the future. Fund annually provides to the tax authorities of Country B the amount of benefits distributed to each participant (or designee). Country B's tax authorities prescribe rules and regulations governing Fund's operations. Under the laws of Country B, Fund is not taxed on its investment income. On January 1, 2024, Fund purchases Property, which is an interest in real property located in the United States. On June 1, 2026, Fund sells Property, realizing \$100x of gain with respect to Property that would be subject to tax under section 897(a) unless paragraph (b) of this section applies with respect to the gain.

(ii) *Analysis.* (A) Fund is a trust that maintains an identifiable pool of assets for the sole purpose of funding retirement and pension benefits and ancillary benefits to current and former employees of the employer group (within the meaning of paragraph (e)(3) of this section) that includes Employer and S1 (current and former employees of Employer and S1 constitute qualified recipients, as defined in paragraph (e)(12)(i)(B) of this section). All assets held by Fund and all income earned by Fund are used to provide such benefits. Therefore, Fund is a trust that maintains a qualified segregated account within the meaning of paragraph (e)(13) of this section. Accordingly, Fund is an eligible fund within the meaning of paragraph (e)(2) of this section.

(B) Because Fund is created or organized under the laws of Country B, Fund satisfies the requirement of paragraph (c)(2)(i) of this section.

(C) The only benefits that Fund provides are retirement and pension benefits described in paragraph (e)(14) of this section and ancillary benefits (that is,

the incidental death benefits) described in paragraph (e)(1) of this section, both of which constitute qualified benefits described in paragraph (e)(8) of this section, to qualified recipients, described in paragraph (e)(12)(i)(B) of this section. Furthermore, Fund satisfies the requirements of the present valuation test as described in paragraphs (c)(2)(ii)(B) and (C) of this section. Accordingly, Fund is established by Employer to provide retirement and pension benefits to qualified recipients in consideration for services rendered by such qualified recipients to Employer and S1, and Fund satisfies the requirement of paragraph (c)(2)(ii) of this section.

(D) No single qualified recipient has a right to more than five percent of the assets or income of the eligible fund. Accordingly, Fund satisfies the requirement of paragraph (c)(2)(iii) of this section.

(E) Fund is regulated and annually provides to the relevant tax authorities in the foreign jurisdiction in which it is established or operates the amount of qualified benefits provided to each qualified recipient by the eligible fund. Accordingly, Fund satisfies the requirements of paragraph (c)(2)(iv) of this section.

(F) Fund is not subject to income tax on its investment income. Accordingly, Fund satisfies the requirement of paragraph (c)(2)(v) of this section.

(G) Because Fund meets the requirements of paragraph (c)(2) of this section, Fund is treated as a qualified foreign pension fund. Furthermore, because Fund held no United States real property interests as of January 1, 2023, the earliest date during an uninterrupted period ending on June 1, 2026, the date of the disposition, in which it satisfied the requirements of paragraph (c)(2) of this section, Fund is a qualified holder under paragraph (d)(2) of this section. All of Fund's assets are held in a qualified segregated account within the meaning of paragraph (e)(13) of this section. Accordingly, under paragraph (b) of this section, the \$100x gain attributable to the disposition of Property is not subject to section 897(a).

(3) *Example 3: Fund established by an employer at the direction of a foreign jurisdiction*—(i) *Facts*. The facts are the same as in paragraph (f)(2) of this section (*Example 2*), except that Fund was established by Employer at the direction of Country B and, in addition to being established to provide retirement and pension benefits to current and former employees of Employer and S1, Fund was also established to provide retirement and pension benefits to other employees. All employees that are beneficiaries provide contributions to Fund. Fund makes a determination on at least an annual basis using a reasonable method to measure the number of participants in the Fund who are not current and former employees of Employer and S1. Each time such a determination is made, Fund finds that such employees constitute less than five percent of Fund's total qualified recipients and do not have a right to more than five percent of the assets or income of Fund.

(ii) *Analysis*. Fund satisfies the requirements of paragraph (c)(2)(ii)(A)(I)(i) of this section because it was established by, or at the direction of, Country B to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees as a result of services rendered by such employees to their employers. Fund also satisfies the requirements of paragraph (c)(2)(ii)(A)(I)(ii) of this section

because it was established by Employer to provide retirement and pension benefits to participants or beneficiaries that are current or former employees or persons designated by such employees in consideration for services rendered by such employees to Employer and S1. Because it satisfies the requirements of both such provisions, under paragraph (c)(2)(ii)(A)(2) of this section, Fund will be treated solely as an eligible fund under paragraph (c)(2)(ii)(A)(I)(ii) of this section. As a result, Fund must meet the reporting requirements described in paragraph (c)(2)(iv)(A) of this section and must apply the definition of qualified recipient described in paragraphs (e)(12)(i)(B) and (C) of this section. Because Fund makes a determination on at least an annual basis using a reasonable method to measure the number of participants in the Fund who are not current and former employees of Employer and S1, finding that such employees constitute less than five percent of Fund's total qualified recipients and do not have a right to more than five percent of the assets or income of Fund, the requirement of paragraph (c)(2)(ii)(B)(I) of this section, requiring that all of the benefits that an eligible fund provides are provided to qualified recipients, is considered satisfied. Because Fund meets the requirements of paragraph (c)(2) of this section, Fund is treated as a qualified foreign pension fund under paragraph (b) of this section. Accordingly, the \$100x gain attributable to the disposition of Property is not subject to section 897(a).

(4) *Example 4: Employer controlled organization or arrangement*—(i) *Facts*. The facts are the same as in paragraph (f)(2) of this section (*Example 2*), except that S2, a Country B corporation that is wholly owned by Employer, performs all tax compliance functions for Employer, S1, and S2, including information reporting with respect to Fund participants.

(ii) *Analysis*. For purposes of the requirements of paragraph (c)(2) of this section, Fund and S2 are an organization or arrangement that is treated as a single entity under paragraph (c)(3)(i)(A) of this section and an eligible fund under paragraph (e)(2) of this section with respect to the qualified segregated account held by Fund. Because the eligible fund composed of Fund and S2 satisfies the requirements of paragraph (c)(2) of this section (including the rule under paragraph (c)(3)(i)(A) of this section that each entity satisfy the foreign organization requirement of paragraph (c)(2)(i) of this section) with respect to the qualified benefits provided to the qualified recipients out of the eligible fund's qualified segregated account (determined in accordance with paragraph (c)(3)(i)(B) of this section), the eligible fund that is composed of Fund and S2 constitutes a qualified foreign pension fund. Furthermore, the requirements for qualified holder status are satisfied, as described in paragraph (f)(2) of this section. Thus, under paragraph (b) of this section, the \$100x gain attributable to the disposition of Property is not subject to section 897(a).

(5) *Example 5: Third-party assumption of pension liabilities*—(i) *Facts*. The facts are the same as in paragraph (f)(2) of this section (*Example 2*), except that Fund does not purchase Property on January 1, 2024. In addition, Fund anticipates \$100x of qualified benefits will be paid each year beginning on January 1, 2028. Fund enters into an agreement with Guarantor, a privately held Country B corporation,

which provides that Fund will, on January 30, 2023, cede a portion of its assets to Guarantor in exchange for annual payments of \$100x beginning on January 1, 2028 and continuing until one or more previously identified participants (and their designees) ceases to be eligible to receive benefits. Guarantor has discretion to invest the ceded assets as it chooses, subject to certain agreed upon investment restrictions. Pursuant to its agreement with Fund, Guarantor must maintain Segregated Pool, a pool of assets securing its obligations under its agreement with Fund. The value of Segregated Pool must exceed a specified amount (determined based on an agreed upon formula) until Guarantor's payment obligations are completed, and any remaining assets in Segregated Pool (that is, assets exceeding the required payments to Fund) are retained by Guarantor. Guarantor bears all investment risk with respect to Segregated Pool. Accordingly, Guarantor is required to make annual payments of \$100x to Fund regardless of the performance of Segregated Pool. On January 1, 2024, Guarantor purchases stock in Company A, a United States real property holding company that is a United States real property interest, and holds the Company A stock in Segregated Pool. On June 1, 2027, Guarantor sells the stock in Company A, realizing a gain of \$100x.

(ii) *Analysis*. The Segregated Pool is not a qualified segregated account, because it is not maintained for the sole purpose of funding qualified benefits to qualified recipients, and because income attributable to assets in the Segregated Pool (including the Company A stock) may inure to Guarantor, which is not a qualified recipient. Accordingly, Fund and Guarantor do not qualify as an organization or arrangement that is an eligible fund with respect to the Company A stock. Therefore, Guarantor is not exempt under paragraph (b) of this section with respect to the \$100x of gain realized in connection with the sale of its shares in Company A.

(6) *Example 6: Asset manager*—(i) *Facts*. The facts are the same as in paragraph (f)(5) of this section (*Example 5*) except that instead of ceding legal ownership of a portion of its assets to Guarantor, Fund transfers the assets into Trust with respect to which Fund is the sole beneficiary on January 30, 2023, and Trust purchases stock in Company A on January 1, 2024. Guarantor has exclusive management authority over the Trust assets and is entitled to a reasonable fixed management fee which it withdraws annually from Trust's assets. On June 1, 2027, Trust sells the stock in Company A, realizing a gain of \$100x.

(ii) *Analysis*. For purposes of testing the requirements of paragraph (c)(2) of this section, Fund and Trust are an organization or arrangement that is treated as a single entity under paragraph (c)(3)(i)(A) of this section and an eligible fund under paragraph (e)(2) of this section. Assets held by Trust are held in a qualified segregated account, and those assets are the assets that are relevant for purposes of determining whether the eligible fund composed of Fund and Trust meets the requirements of paragraph (c)(2) of this section. The eligible fund that is composed of Fund and Trust is treated as established by Employer notwithstanding that Guarantor provides management services. See paragraph (c)(2)(ii)(A)(3) of this section. Paragraph (e)(13)(ii) of this section provides

that the assets held by an eligible fund in a qualified segregated account may be used to satisfy reasonable expenses of the eligible fund, such that the reasonable fixed management fee paid to Guarantor does not cause the assets held in Trust to fail to be treated as held in a qualified segregated account. All of the other requirements for qualified foreign pension fund status are satisfied by the eligible fund that is composed of Fund and Trust, as described in paragraph (f)(2) of this section. The eligible fund that is composed of Fund and Trust is a qualified holder under paragraph (d)(2) of this section because it held no United States real property interests on January 1, 2023, the earliest date during an uninterrupted period ending on June 1, 2027, the date of the disposition of Company A stock, in which it satisfied the requirements of paragraph (c)(2) of this section. The eligible fund that is composed of Fund and Trust is therefore exempt under paragraph (b) of this section with respect to the \$100x of gain realized in connection with the sale by Trust of the shares in Company A.

(7) *Example 7: Partnership*—(i) *Facts*. The facts are the same as in paragraph (f)(5) of this section (*Example 5*) except that instead of ceding legal ownership of the assets to Guarantor, Fund contributes the assets to a partnership (PRS) formed with Guarantor and PRS purchases stock in Company A on January 30, 2023. Guarantor receives a profits interest in the partnership that is reasonable in light of Guarantor's management activity. Guarantor has no direct or indirect ownership in PRS assets, and the partnership agreement provides that upon dissolution, PRS assets would be distributed to Fund. Guarantor serves as the general partner of PRS and has discretionary authority to buy and sell PRS assets without approval from Fund. On June 1, 2027, PRS sells the stock in Company A, realizing a gain of \$100x.

(ii) *Analysis*. All of Fund's assets, including the assets held by PRS that are treated as held proportionately by Fund under paragraph (c)(3)(ii) of this section, are held in a qualified segregated account within the meaning of paragraph (e)(13) of this section. See paragraph (f)(2)(ii)(A) of this section (*Example 2*). The eligible fund that is composed of Fund is treated as established by Employer notwithstanding that Guarantor provides management services to PRS. See paragraphs (c)(2)(ii)(A)(3) and (c)(3)(ii) of this section. All of the other requirements for qualified foreign pension fund status are satisfied by Fund as described in paragraphs (f)(2)(ii)(B) through (F) of this section, and Fund is a qualified holder as described in paragraph (f)(2)(ii)(G) of this section. Accordingly, Fund is exempt under paragraph (b) of this section with respect to its allocable share of the \$100x of gain realized in connection with the sale by PRS of the shares in Company A. Guarantor is not exempt under paragraph (b) of this section with respect to its allocable share of the \$100x of gain realized in connection with the sale by PRS of the shares in Company A because Guarantor is neither part of the organization or arrangement that forms Fund nor a qualified holder under paragraph (d) of this section that maintains qualified segregated accounts.

(8) *Example 8: Not a qualified holder*—(i) *Facts*. Fund is a qualified foreign pension fund organized in Country C that meets the requirements of paragraph (c)(2) of this section. Fund owns all the outstanding stock of OpCo, a manufacturing corporation orga-

nized in Country C, in a qualified segregated account maintained by Fund. OpCo was originally formed by a person other than Fund on January 1, 2023. Fund purchased all of the stock of OpCo on November 1, 2023 for the purpose of conducting the manufacturing business and utilizing the business profits to fund pension liabilities. During the period from January 1, 2023, through October 31, 2023, OpCo was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity. On January 30, 2023, OpCo purchased Property A, a United States real property interest, from a third party. For all periods after Fund acquired OpCo, OpCo must either retain or distribute to Fund all of its net earnings, and upon dissolution, must distribute all of its assets to its stockholder (that is, Fund) after satisfaction of liabilities to its creditors. On June 1, 2024, OpCo realizes \$100x of gain on the disposition of Property A.

(ii) *Analysis*. (A) A qualified controlled entity described in paragraph (e)(9) of this section includes any corporation organized under the laws of a foreign jurisdiction all the interests of which are owned by one or more qualified foreign pension funds directly or indirectly through one or more qualified controlled entities. Fund is a qualified foreign pension fund that wholly owns OpCo. Accordingly, OpCo is a qualified controlled entity for the period when it is owned by Fund beginning on November 1, 2023.

(B) Under paragraph (d)(1) of this section, a qualified controlled entity is a qualified holder only if either, under paragraph (d)(2) of this section, the qualified controlled entity owned no United States real property interests as of the earliest date during an uninterrupted period ending on the date of the disposition or distribution in which the qualified controlled entity satisfied the requirements of paragraph (e)(9) of this section, or, under paragraph (d)(3) of this section, the qualified controlled entity satisfies the requirements of paragraph (e)(9) of this section throughout the entire testing period. Because OpCo owned a United States real property interest as of November 1, 2023, the earliest date during an uninterrupted period ending on the date of the disposition during which it satisfied the requirements of paragraph (e)(9) of this section, OpCo cannot satisfy the requirements of paragraph (d)(2) of this section and must instead satisfy the requirements of paragraph (d)(3) of this section to be a qualified holder. Under paragraph (d)(3) of this section, a qualified holder does not include any entity that was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity at any time during the testing period. The testing period with respect to OpCo is the period from January 1, 2023 (the date of OpCo's formation), to June 1, 2024 (the date of the disposition). Because OpCo was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity from January 1, 2023, to October 31, 2023, OpCo was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity at all times during the testing period. Accordingly, OpCo is not a qualified holder with respect to the disposition of Property A, and the \$100x of gain recognized by OpCo is not exempt from tax under section 897(l), regardless of the amount of unrealized gain in Property A as of November 1, 2023.

(9) *Example 9: 48-month alternative test*—(i) *Facts*. Fund is a qualified foreign pension fund organized in Country C that, except as otherwise noted, meets the requirements of paragraph (c)(2) of this section. Fund owns all the outstanding stock of OpCo, a manufacturing corporation organized in Country C and formed by Fund on January 1, 2023, in a qualified segregated account maintained by Fund. On January 30, 2023, OpCo purchased Property A, a United States real property interest, from a third party. OpCo either retains or distributes to Fund all of its net earnings, and upon dissolution, must distribute all of its assets to its stockholder (that is, Fund) after satisfaction of liabilities to its creditors. On June 1, 2027, OpCo realizes \$100x of gain on the disposition of Property A. Fund reasonably expected to provide \$90x of retirement and pension benefits and \$100x of qualified benefits for the valuations that it performed pursuant to paragraph (c)(2)(ii)(C)(I) of this section on December 31, 2023, December 31, 2024, and December 31, 2025. Fund reasonably expected to provide \$160x of retirement and pension benefits and \$200x of qualified benefits for the valuation that it performed pursuant to paragraph (c)(2)(ii)(C)(I) of this section on December 31, 2026.

(ii) *Analysis*. In each of the years ending on December 31, 2023, December 31, 2024, and December 31, 2025, the valuation performed pursuant to paragraph (c)(2)(ii)(C)(I) of this section demonstrates that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$90x of retirement and pension benefits constitutes 90 percent of the total \$100x of qualified benefits. For the year ending on December 31, 2026, the valuation performed pursuant to paragraph (c)(2)(ii)(C)(I) of this section does not demonstrate that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$160x of retirement and pension benefits constitutes only 80 percent of the total \$200x of qualified benefits. Thus, Fund does not meet the requirements of paragraph (c)(2)(ii)(C)(I) of this section for the year ending on December 31, 2026. However, under the 48-month alternative calculation in paragraph (c)(2)(ii)(C)(2) of this section, Fund satisfies the requirement that it reasonably expects to provide 85 percent retirement and pension benefits to qualified recipients as of December 31, 2026. This is because when averaging the values (not percentages) of the qualified benefits and retirement and pension benefits that Fund reasonably expected to provide from the valuations performed over the preceding 48 months (including the most recent valuation), Fund divides the total retirement and pension benefits of \$430x (\$90x + \$90x + \$90x + \$160x) by the total qualified benefits that it reasonably expected to provide of \$500x (\$100x + \$100x + \$100x + \$200x) for an average of 86 percent. Under paragraph (c)(2)(ii)(C)(3) of this section, Fund may rely on either the most recent present valuation described in paragraph (c)(2)(ii)(C)(I) of this section or the alternative calculation in paragraph (c)(2)(ii)(C)(2) of this section, both of which are determined as of December 31, 2026. Because Fund satisfies the requirements of paragraph (c)(2)(ii)(B)(2) of this section under the test in paragraph (c)(2)(ii)(C)(2) of this section, even though it does not do so under the test in paragraph (c)(2)(ii)(C)(I) of this section, Fund is a qualified foreign pension fund with respect to the

disposition on June 1, 2027. Because OpCo is held by a qualified foreign pension fund as of the date of the disposition, OpCo is a qualified controlled entity within the meaning of paragraph (e)(9) of this section. Accordingly, the \$100x of gain realized by OpCo is exempt from tax under section 897(l).

(10) *Example 10: 48-month alternative test with multiple valuations in the same year—(i) Facts.* The facts are the same as in paragraph (f)(9) of this section (Example 9), except that in the year ending December 31, 2023, Fund carried out two valuations pursuant to paragraph (c)(2)(ii)(C)(1) of this section, one on June 30, 2023 and the second on December 31, 2023. For each valuation, Fund reasonably expected to provide \$90x of retirement and pension benefits and \$100x of qualified benefits. In addition, in the year ending on December 31, 2026, pursuant to a valuation carried out under paragraph (c)(2)(ii)(C)(1) of this section, Fund reasonably expected to provide \$150x retirement and pension benefits and \$200x of qualified benefits.

(ii) *Analysis.* In each of the years ending on December 31, 2023, December 31, 2024, and December 31, 2025 (including the two valuations performed in 2023), the valuation performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section demonstrates that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$90x of retirement and pension benefits constitutes 90 percent of the total \$100x of qualified benefits. For the year ending on December 31, 2026, the valuation performed pursuant to paragraph (c)(2)(ii)(C)(1) of this section does not demonstrate that the requirements of paragraph (c)(2)(ii)(B)(2) of this section have been met because \$150x of retirement and pension benefits constitutes 75 percent of the total \$200x of qualified benefits. Thus, Fund does not meet the requirements of paragraph (c)(2)(ii)(C)(1) of this section for the year ending on December 31, 2026. Under the 48-month alternative calculation in paragraph (c)(2)(ii)(C)(2) of this section, Fund also does not satisfy the requirement that it reasonably expects to provide 85 percent retirement and pension benefits to qualified recipients as of December 31, 2026. This is because when averaging the values (not percentages) of the qualified benefits and retirement and pension benefits that Fund reasonably expected to provide from the valuations performed over the preceding 48 months (including the most recent valuation), Fund must use a weighted average whereby values are adjusted when the length of valuation periods differs. In this case, each of the two valuations in 2023 must be divided by two for a total weighted average for each valuation of \$45x retirement and pension benefits and \$50x of qualified benefits. When Fund then divides the total retirement and pension benefits that it reasonably expected to provide of \$420x (\$45x + \$45x + \$90x + \$90x + \$150x) by the total qualified benefits that it reasonably expected to provide of \$500x (\$50x + \$50x + \$100x + \$100x + \$200x), the average is 84 percent. Because Fund does not satisfy the requirements of paragraph (c)(2)(ii)(B)(2) of this section under the test in paragraph (c)(2)(ii)(C)(2) of this section or the test in paragraph (c)(2)(ii)(C)(1) of this section, Fund is not a qualified foreign pension fund with respect to the disposition on June 1, 2027. Because OpCo is not held by a qualified foreign pension fund as of the date of the disposition, OpCo is

not a qualified controlled entity within the meaning of paragraph (e)(9) of this section. Accordingly, the \$100x of gain realized by OpCo is not exempt from tax under section 897(l).

(11) *Example 11: Qualified foreign pension fund as qualified holder—(i) Facts.* The facts are the same as in paragraph (f)(10) of this section (Example 10), except that OpCo does not dispose of Property A on June 1, 2027 and Fund reasonably expects to provide 85 percent of retirement and pension benefits to qualified recipients in the future in each of the annual present valuations it performs as of December 31, 2027 through December 31, 2033. Fund also satisfies the other requirements of paragraph (c)(2) of this section during this period. On April 1, 2029, Fund purchases Property B, a United States real property interest, and holds it in a qualified segregated account. On June 1, 2034, Fund realizes \$100x of gain on the disposition of Property B and OpCo realizes \$100x of gain on the disposition of Property A. At least 85 percent and no more than five percent of the actual value of the aggregate benefits provided by Fund before December 31, 2033, the most recent present value determination, were retirement and pension benefits and non-ancillary benefits, respectively.

(ii) *Analysis.* (A) Because Fund reasonably expected to provide 85 percent of retirement and pension benefits to qualified recipients as of the valuation performed on December 31, 2033, and it met the other requirements of paragraph (c)(2) of this section, Fund is a qualified foreign pension fund under paragraph (c)(2)(ii)(C)(3) of this section for the twelve months succeeding the most recent valuation, which includes June 1, 2034, the date of the disposition of Property A and Property B.

(B) Fund is a qualified holder under paragraph (d)(2) of this section because Fund did not own any United States real property interests as of December 31, 2027, the earliest date during the uninterrupted period ending on the date of the disposition, June 1, 2034, during which it satisfied the requirements of paragraph (c)(2) of this section and therefore qualified as a qualified foreign pension fund. Fund is eligible for the exemption under section 897(l) with respect to the disposition of Property B because it held Property B in a qualified segregated account. Thus, the \$100x of gain realized by Fund on the disposition of Property B is exempt from tax under section 897(l).

(C) Because OpCo owned Property A, a United States real property interest, as of December 31, 2027, the earliest date during an uninterrupted period ending on the date of the disposition, June 1, 2034, during which it was a qualified controlled entity, OpCo cannot satisfy the requirements of paragraph (d)(2) of this section and must instead satisfy the requirements of paragraph (d)(3) of this section to be a qualified holder. The testing period with respect to OpCo, determined under paragraph (d)(3)(ii) of this section, ends on June 1, 2034 (the date of the disposition) and begins on June 1, 2024 (the date that is ten years before the disposition date). Because Fund failed to qualify as a qualified foreign pension fund as of December 31, 2026, OpCo was not continuously owned by a qualified foreign pension fund for the duration of the testing period, and thus did not qualify as a qualified foreign pension fund, part of a qual-

ified foreign pension fund, or a qualified controlled entity for the duration of the testing period. As a result, OpCo is not a qualified holder under paragraph (d)(3) of this section. Accordingly, the \$100x of gain recognized by OpCo on the disposition of Property A is not exempt from tax under section 897(l).

(12) *Example 12: Qualified controlled entity as qualified holder—(i) Facts.* Fund is a qualified foreign pension fund organized in Country C that meets the requirements of paragraph (c)(2) of this section as of December 31, 2022 and December 31, 2023. Fund purchases an interest in Company A, a United States real property holding company, on June 1, 2024. As of December 31, 2024, Fund fails to satisfy the present valuation requirement of paragraph (c)(2)(ii)(B)(2) of this section and does not satisfy the alternative calculation under paragraph (c)(2)(ii)(C)(2) of this section. From December 31, 2025, through December 31, 2030, Fund satisfies the present valuation requirement of paragraph (c)(2)(ii)(B)(2) of this section and meets all other requirements in paragraph (c)(2) of this section to be treated as a qualified foreign pension fund. On June 1, 2026, Fund purchases all of the stock of Company B, a Country C corporation that owns no United States real property interests and is not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity. On January 1, 2027, Company B purchases Property D, a United States real property interest. Company B retains or distributes to Fund all of its net earnings, and upon dissolution, must distribute all of its assets to its stockholders (that is, Fund) after satisfaction of liabilities to its creditors. On June 1, 2031, Fund realizes \$100x of gain on the disposition of stock in Company A, and Company B realizes \$100x of gain on the disposition of Property D.

(ii) *Analysis.* (A) Fund owned Company A, a United States real property holding company, as of December 31, 2025, the earliest date during an uninterrupted period ending on the date of the disposition, June 1, 2031, during which Fund satisfied the requirements of paragraph (c)(2) of this section. Accordingly, to be a qualified holder, Fund must satisfy the requirements of paragraph (d)(3) of this section. The testing period with respect to Fund, determined under paragraph (d)(3) of this section, ends on June 1, 2031 (the date of disposition) and begins on June 1, 2021 (the date that is ten years before the disposition date). Fund is not a qualified holder because it failed to satisfy the requirements of paragraph (c)(2) of this section as of December 31, 2024 and, thus, has not satisfied the requirements of paragraph (c)(2) of this section continuously for the duration of the testing period. Accordingly, the \$100x of gain realized by Fund on the disposition of the stock of Company A is not exempt from tax under section 897(l).

(B) Although Fund is not a qualified holder as of June 1, 2031, the date of Company B's disposition of Property D, Fund is still a qualified foreign pension fund because it satisfies the requirements of paragraph (c)(2) of this section. Company B is therefore a qualified controlled entity within the meaning of paragraph (e)(9) of this section as of June 1, 2031, because it is wholly owned by Fund, a qualified foreign pension fund. Notwithstanding that Fund is not a qualified holder under either paragraph (d)(2) or (3) of this section, Company B

is a qualified holder under paragraph (d)(2) of this section because Company B did not own a United States real property interest as of June 1, 2026, the earliest date during an uninterrupted period ending on June 1, 2031 (the date of the disposition) during which Company B was a qualified controlled entity. Lastly, all of Company B's assets constitute a qualified segregated account. Accordingly, the \$100x of gain realized by Company B on the disposition of Property D is exempt from tax under section 897(l).

(g) *Applicability date*—(1) *In general.* Except as otherwise provided in paragraph (g)(2) of this section, this section applies to dispositions of United States real property interests and distributions described in section 897(h) occurring on or after December 29, 2022.

(2) *Certain provisions.* Paragraphs (b)(1), (d), (e)(5) and (e)(9) of this section apply with respect to dispositions of United States real property interests and distributions described in section 897(h) occurring on or after June 6, 2019.

(3) *Early application.* An eligible fund may choose to apply this section with respect to dispositions and distributions occurring on or after December 18, 2015, and before December 29, 2022, provided that the eligible fund, and all persons bearing a relationship to the eligible fund described in section 267(b) or 707(b), consistently apply the rules in this section for all relevant years. An eligible fund that chooses to apply this section pursuant to this paragraph (g)(3) must apply the principles of paragraph (d)(4)(i) of this section to any valuation requirements with respect to dates preceding December 18, 2015.

Par. 3. Section 1.1441-3 is amended by revising paragraphs (c)(4)(i) introductory text, (c)(4)(i)(B)(2), and (c)(4)(i)(C) and adding paragraph (c)(4)(iii) to read as follows:

§1.1441-3 Determination of amounts to be withheld.

(c) ***

(4) ***

(i) *In general.* A distribution from a U.S. Real Property Holding Corporation (USRPHC) (or from a corporation that was a USRPHC at any time during the five-year period ending on the date of distribution) with respect to stock that is a U.S. real property interest under section

897(c) or from a Real Estate Investment Trust (REIT) or other entity that is a qualified investment entity (QIE) under section 897(h)(4) with respect to its stock is subject to the withholding provisions under section 1441 (or section 1442 or 1443) and section 1445. A USRPHC (other than a REIT or other entity that is a QIE) making a distribution shall be treated as satisfying its withholding obligations under both sections if it withholds in accordance with one of the procedures described in either paragraph (c)(4)(i)(A) or (B) of this section. A USRPHC must apply the same withholding procedure to all the distributions made during the taxable year. However, the USRPHC may change the applicable withholding procedure from year to year. For rules regarding distributions by REITs and other entities that are QIEs, see paragraph (c)(4)(i)(C) of this section. To the extent withholding under sections 1441, 1442, or 1443 applies under this paragraph (c)(4)(i) to any portion of a distribution that is a withholdable payment, see paragraph (a)(2) of this section for rules coordinating withholding under chapter 4.

(B) ***

(2) Withhold under section 1445(e)(3) and §1.1445-5(e) on the remainder of the distribution (except for any portion paid to a withholding qualified holder (as defined in §1.1445-1(g)(11)) or on such smaller portion based on a withholding certificate obtained in accordance with §1.1445-5(e)(3)(iv).

(C) *Coordination with REIT/QIE withholding.* In the case of a distribution from a REIT or other entity that is a QIE, withholding is required as described in paragraph (c)(4)(i)(C)(I) and (2) of this section.

(I) Withholding is required under section 1441 (or 1442 or 1443) on—

(i) The portion of the distribution that is not designated (for REITs) or reported (for regulated investment companies that are QIEs) as a capital gain dividend, a return of basis, or a distribution in excess of a shareholder's adjusted basis in the stock of the REIT or QIE that is treated as a capital gain under section 301(c)(3); and

(ii) Any portion of a capital gain dividend from a REIT or other entity that is a QIE that is not treated as gain attribut-

able to the sale or exchange of a U.S. real property interest pursuant to the second sentence of section 897(h)(1)).

(2) Withholding is required under section 1445 with respect to—

(i) A distribution in excess of a shareholder's adjusted basis in the stock of the REIT or QIE is, unless the interest in the REIT or QIE is not a U.S. real property interest (for example, an interest in a domestically controlled REIT or QIE under section 897(h)(2)) or the distribution is paid to a withholding qualified holder (as defined in §1.1445-1(g)(11)); and

(ii) Any portion of a capital gain dividend that is attributable to the sale or exchange of a U.S. real property interest under section 897(h)(1), unless it is paid to a withholding qualified holder (as defined in §1.1445-1(g)(11)). See §1.1445-8.

(iii) *Applicability date.* Paragraphs (c)(4)(i), (c)(4)(i)(B)(2), and (c)(4)(i)(C) of this section apply to distributions made by a USRPHC or a QIE occurring on or after December 29, 2022. For distributions made by a USRPHC or a QIE occurring before December 29, 2022, see §1.1441-3(c)(4)(i), (c)(4)(i)(B)(2), and (c)(4)(i)(C), as contained in 26 CFR part 1, revised as of April 1, 2021.

Par. 4. Section 1.1445-1 is amended by adding paragraph (g)(11) to read as follows:

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

(g) ***

(11) *Withholding qualified holder.* A withholding qualified holder means a qualified holder (under §1.897(l)-1(d)), and a foreign partnership all of the interests of which are held by qualified holders (under §1.897(l)-1(d)), including through one or more partnerships.

Par. 5. Section 1.1445-2 is amended by:

1. Revising paragraph (b)(2)(i);
2. Adding paragraph (b)(2)(vi); and
3. Adding two sentences at the end of paragraph (e).

The revisions and addition read as follows:

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

* * * * *

(b) * * *

(2) * * *

(i) *In general.* The rules in this paragraph (b)(2)(i) apply for purposes of the transferor's certification of non-foreign status (including a certification of non-foreign status provided by a withholding qualified holder (as defined in §1.1445-1(g)(11))).

(A) A transferee of a U.S. real property interest is not required to withhold under section 1445(a) if, before or at the time of the transfer, the transferor furnishes to the transferee a certification that is signed under penalties of perjury and –

(1) States that the transferor is not a foreign person; and

(2) Sets forth the transferor's name, identifying number and home address (in the case of an individual) or office address (in the case of an entity).

(B) For purposes of paragraph (b)(2)(i)(A) of this section, a foreign person is a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate, except that a withholding qualified holder (as defined in §1.1445-1(g)(11)) is not a foreign person. Additionally, a foreign corporation that has made a valid election under section 897(i) is generally not treated as a foreign person for purposes of section 1445. In this regard, see §1.1445-7. Pursuant to §1.897-1(p), an individual's identifying number is the individual's Social Security number and any other person's identifying number is its U.S. employer identification number (EIN), or, if the transferor is a withholding qualified holder (as defined in §1.1445-1(g)(11)) that does not have a U.S. taxpayer identification number, a foreign tax identification number issued by its jurisdiction of residence. A certification pursuant to this paragraph (b) must be verified as true and signed under penalties of perjury by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, and by a trustee, executor, or equivalent fiduciary in the case of a trust or estate. No particular form is needed for a certification pursuant to this paragraph (b), nor is

any particular language required, so long as the document meets the requirements of this paragraph (b)(2)(i), except that, with respect to a certification submitted by a withholding qualified holder (as defined in §1.1445-1(g)(11)), the transferor must state on the certification that it is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). Samples of acceptable certifications are provided in paragraph (b)(2)(iv) of this section.

* * * * *

(vi) *Form W-8EXP.* A certification of non-foreign status may be made by a withholding qualified holder (as defined under §1.1445-1(g)(11)) as provided in paragraph (b)(2)(i) of this section to certify its qualified holder status. A certification of non-foreign status under paragraph (b)(2)(i) of this section also includes a certification made on a Form W-8EXP (or its successor) that states that the transferor is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). The certification must also meet all of the other requirements for a valid Form W-8EXP (or its successor) as provided on the form and the instructions to the form. A qualified holder may not provide a certification of non-foreign status on a Form W-9 (or its successor) as permitted in paragraph (b)(2)(v) of this section.

* * * * *

(e) * * * Paragraphs (b)(2)(i) and (b)(2)(vi) of this section, apply with respect to dispositions of U.S. real property interests and distributions described in section 897(h) occurring on or after December 29, 2022. For dispositions of U.S. real property interests and distributions described in section 897(h) occurring before December 29, 2022, see §1.1445-2(b)(2)(i) and (b)(2)(vi), as contained in 26 CFR part 1, revised as of April 1, 2021.

Par. 6. Section 1.1445-5 is amended by revising paragraphs (b)(3)(ii)(A), (B), and

(D) and adding two sentences at the end of paragraph (h) to read as follows:

§1.1445-5 Special rules concerning distributions and other transactions by corporations, partnerships, trusts, and estates.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(A) *In general.* For purposes of this section, an entity or fiduciary may treat any holder of an interest in the entity as a U.S. person if that interest-holder furnishes to the entity or fiduciary a certification stating that the interest-holder is not a foreign person, in accordance with the provisions of paragraph (b)(3)(ii)(B) of this section. In general, a foreign person is a nonresident alien individual, foreign corporation, foreign partnership, foreign trust, or foreign estate, except that a withholding qualified holder (as defined in §1.1445-1(g)(11)) is not a foreign person for purposes of this section.

(B) *Procedural rules.* The rules in this paragraph (b)(3)(ii)(B) apply for purposes of the interest-holder's certification of non-foreign status (including a certification of non-foreign status provided by a withholding qualified holder (as defined in §1.1445-1(g)(11))).

(1) An interest-holder's certification of non-foreign status must be signed under penalties of perjury and must state –

(i) That the interest-holder is not a foreign person; and

(ii) The interest-holder's name, identifying number, home address (in the case of an individual), or office address (in the case of an entity), and place of incorporation (in the case of a corporation).

(2) For purposes of paragraph (b)(3)(ii)(B)(1) of this section, an individual's identifying number is the individual's Social Security number and any other person's identifying number is its U.S. employer identification number (see § 1.897-1(p)), or, if the interest-holder is a withholding qualified holder (as defined in §1.1445-1(g)(11)) that does not have a U.S. taxpayer identification number, a foreign tax identification number issued by its jurisdiction of residence. The certification must be signed by a responsible officer

in the case of a corporation, by a general partner in the case of a partnership, and by a trustee, executor, or equivalent fiduciary in the case of a trust or estate. No particular form is needed for a certification pursuant to this paragraph (b)(3)(ii), nor is any particular language required, so long as the document meets the requirements of this paragraph, except that, with respect to certification submitted by a withholding qualified holder (as defined in §1.1445-1(g)(11)), the transferor must state on the certification that it is treated as a non-foreign person because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). Samples of acceptable certifications are provided in paragraph (b)(3)(ii)(E) of this section.

(3) An entity may rely upon a certification pursuant to this paragraph (b)(3)(ii)(B) for a period of two calendar years following the close of the calendar year in which the certification was given. If an interest holder becomes a foreign person (or no longer is treated as a withholding qualified holder (as defined in §1.1445-1(g)(11)) and therefore is no longer treated as a non-foreign person for purposes of withholding under section 1445 within the period described in the preceding sentence, the interest-holder must notify the entity before any further dispositions or distributions and upon receipt of such notice (or any other notification of the foreign status of the interest-holder) the entity may no longer rely upon the prior certification. An entity that obtains and relies upon a certification must retain that certification with its books and records for a period of three calendar years following the close of the last calendar year in which the entity relied upon the certification.

(D) *Form W-8EXP.* A certification of non-foreign status can be made by a withholding qualified holder (as defined in §1.1445-1(g)(11)) as provided in this paragraph (b)(3)(ii) to certify its qualified holder status. A certification of non-foreign status under this paragraph (b)(3)(ii) also includes a certification made on a Form W-8EXP that states that the interest-holder is treated as a non-foreign per-

son because it is a withholding qualified holder and must further specify whether it qualifies as a withholding qualified holder because it is a qualified holder under §1.897(l)-1(d) or a foreign partnership that satisfies the requirements of §1.1445-1(g)(11). The certification must also meet all of the other requirements for a valid Form W-8EXP as provided on the form and the instructions to the form. A qualified holder may not provide a certification of non-foreign status on a Form W-9, as described in paragraph (b)(3)(iv) of this section.

(h) *** Paragraph (b)(3)(ii)(A) of this section applies with respect to dispositions of U.S. real property interests and distributions described in section 897(h) occurring on or after December 29, 2022. For dispositions of U.S. real property interests and distributions described in section 897(h) occurring before December 29, 2022, see §1.1445-5(b)(3)(ii)(A), as contained in 26 CFR part 1, revised as of April 1, 2021.

Par. 7. Section 1.1445-8 is amended by revising paragraph (e) and adding two sentences after the first sentence in paragraph (j) to read as follows:

§1.1445-8 Special rules regarding publicly traded partnerships, publicly traded trusts and real estate investment trusts (REITs).

(e) *Determination of non-foreign status by withholding agent.* A withholding agent may rely on a certification of non-foreign status pursuant to §1.1445-5(b)(3)(ii) to determine whether an interest holder is not a foreign person. Reliance on these documents will excuse the withholding agent from liability imposed under section 1445(e)(1) in the absence of actual knowledge that the interest holder is a foreign person. A withholding agent may also employ other means to determine the status of an interest holder, but, if the agent relies on such other means and the interest holder proves, in fact, to be a foreign person (or, is not a withholding qualified holder (as defined in §1.1445-1(g)(11)) and therefore is not treated as a non-foreign person for purposes of withholding under section 1445), then the withholding agent is subject to any liability imposed

pursuant to section 1445 and the regulations thereunder for failure to withhold. See also §1.1445-5(b)(3)(ii)(B)(3) for the period during which a withholding agent may rely on a certification of non-foreign status submitted by a withholding qualified holder (as defined in §1.1445-1(g)(11)), which applies under this paragraph (e).

(j) *** Paragraph (e) of this section applies with respect to distributions made on or after December 29, 2022. For distributions made before December 29, 2022, see §1.1445-8(e) as contained in 26 CFR part 1, as revised April 1, 2021.***

Par. 8. Section 1.1446-1 is amended by revising the second sentence of paragraph (c)(2)(ii)(G) and by revising paragraph (c)(2)(ii)(H) to read as follows:

§1.1446-1 Withholding tax on foreign partners' share of effectively connected taxable income.

(c) ***

(2) ***

(ii) ***

(G) *** However, except as set forth in §1.1446-2(b)(4)(iii) (regarding withholding qualified holders (as defined in §1.1445-1(g)(11)) and §1.1446-3(c)(3) (regarding certain tax-exempt organizations described in section 501(c)), the submission of Form W-8EXP (or successor) will have no effect on whether there is a 1446 tax due with respect to such partner's allocable share of partnership ECTI.***

(H) *Foreign corporations, certain foreign trusts, and foreign estates.* Consistent with the rules of this paragraph (c)(2) and paragraph (c)(3) of this section, a foreign corporation, a foreign trust (other than a foreign grantor trust described in paragraph (c)(2)(ii)(E) of this section), or a foreign estate may generally submit any appropriate Form W-8 (for example, Form W-8BEN-E or Form W-8IMY) to the partnership to establish its foreign status for purposes of section 1446. In addition, a foreign entity may also submit a certification of non-foreign status (including a Form W-8EXP) described in §1.1445-5(b)(3)(ii) for purposes of documenting itself as a withholding qualified holder (as defined in §1.1445-1(g)(11)).

* * * * *

Par. 9. Section 1.1446-2 is amended by adding paragraph (b)(4)(iii) to read as follows:

§1.1446-2 Determining a partnership's effectively connected taxable income allocable to foreign partners under section 704.

* * * * *

(b) * * *

(4) * * *

(iii) *Special rule for qualified holders.*

With respect to a foreign partner that is a withholding qualified holder (as defined in §1.1445-1(g)(11)), the foreign partner's allocable share of partnership ECTI does not include gain or loss that is not taken into account under §1.897(l)-1(b) and that is not otherwise treated as effec-

tively connected with a trade or business in the United States. The partnership must have received from the partner a valid certificate of non-foreign status (including a Form W-8EXP) described in §1.1445-2(b)(2)(i) or §1.1445-5(b)(3)(ii). See §1.1446-1(c)(2)(ii)(G) and (H) regarding documentation of withholding qualified holders.

* * * * *

Par. 10. Section 1.1446-7 is amended by adding two sentences at the end to read as follows:

§1.1446-7 Applicability dates.

* * * Sections 1.1446-1(c)(2)(ii)(G) and (H) and 1.1446-2(b)(4)(iii) apply with respect to dispositions of U.S. real property interests and distributions described in section 897(h) occurring on

or after December 29, 2022. For dispositions of U.S. real property interests and distributions described in section 897(h) occurring before December 29, 2022, see §§1.1446-1(c)(2)(ii)(G) and (H), as contained in 26 CFR part 1, revised as of April 1, 2021.

Melanie R. Krause,
*Acting Deputy Commissioner for
Services and Enforcement.*

Approved: December 9, 2022

Lily Batchelder,
*Assistant Secretary of the Treasury
(Tax Policy).*

(Filed by the Office of the Federal Register on December 28, 2022, 8:45 a.m., and published in the issue of the Federal Register for December 29, 2022, 87 FR 80042)

Part III

Certain Definitions of Terms in Section 30D Clean Vehicle Credit

Notice 2023-1

SECTION 1. PURPOSE

This notice informs taxpayers that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to propose regulations under § 30D of the Internal Revenue Code (Code) (forthcoming proposed regulations) addressing the definitions of certain terms relevant to the requirements of the clean vehicle credit available under § 30D (§ 30D credit).¹

SECTION 2. BACKGROUND

Section 13401 of Public Law 117-169, 136 Stat. 1818 (August 16, 2022), commonly known as the Inflation Reduction Act of 2022 (IRA), amended § 30D. In general, the amendments made by § 13401 of the IRA to § 30D apply to vehicles placed in service after December 31, 2022, except as provided in § 13401(k)(2) through (5) of the IRA.

As amended by § 13401(b) of the IRA, § 30D(d)(1)(G) requires, as of August 17, 2022, any vehicle eligible for the § 30D credit to undergo final assembly in North America. Section 30D(d)(5) defines “final assembly” as the process by which a manufacturer produces a new clean vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.

New § 30D(f)(10)(A) provides that no § 30D credit is allowed for any taxable

year if (i) the lesser of (I) the modified adjusted gross income of the taxpayer for such taxable year, or (II) the modified adjusted gross income of the taxpayer for the preceding taxable year, exceeds (ii) the threshold amount. New § 30D(f)(10)(B) provides that the threshold amount shall be (i) in the case of a joint return or a surviving spouse (as defined in § 2(a)), \$300,000, (ii) in the case of a head of household (as defined in § 2(b)), \$225,000, and (iii) in the case of any other taxpayer, \$150,000. New § 30D(f)(10)(C) defines “modified adjusted gross income” as adjusted gross income increased by any amount excluded from gross income under § 911, 931, or 933.

New § 30D(f)(11)(A) provides that no § 30D credit is allowed for a vehicle with a manufacturer’s suggested retail price in excess of the applicable limitation. New § 30D(f)(11)(B) provides that the applicable limitation for each vehicle classification is as follows: in the case of a van, \$80,000; in the case of a sport utility vehicle, \$80,000; in the case of a pickup truck, \$80,000; and in the case of any other vehicle, \$55,000. New § 30D(f)(11)(C) authorizes the Secretary of the Treasury or her delegate (Secretary) to prescribe such regulations or other guidance as the Secretary determines necessary to determine vehicle classifications using criteria similar to that employed by the Environmental Protection Agency and the Department of the Energy to determine size and class of vehicles.

SECTION 3. GUIDANCE TO BE ISSUED

The Treasury Department and the IRS intend to issue the forthcoming proposed regulations to address the amendments made to § 30D by the IRA. The forthcoming proposed regulations will include definitions of the following terms, which are relevant for new clean vehicles placed in service after December 31, 2022:

1. Final Assembly
2. North America
3. Manufacturer’s Suggested Retail Price
4. Vehicle Classifications for vans, sport utility vehicles, pickup trucks, and other vehicles
5. Placed in service

In addition, the forthcoming proposed regulations will provide guidance regarding the critical mineral and battery component requirements under § 30D(e).² The remainder of this section 3 describes a subset of the expected content of the forthcoming proposed regulations.

.01 Final Assembly

For purposes of § 30D(d)(5), “final assembly” means the process by which a manufacturer produces a new clean vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.

To establish where final assembly of a new clean vehicle occurred, the taxpayer may rely on the following information: (1) the vehicle’s plant of manufacture as reported in the vehicle identification number pursuant to 49 CFR 565; or (2) the final assembly point reported on the label affixed to the vehicle as described in 49 CFR 583.5(a)(3).

.02 North America

For purposes of § 30D(d)(1)(G), “North America” means the territory of the United States, Canada, and Mexico as defined in 19 C.F.R. part 182, Appendix A, § 1(1).

.03 Manufacturer’s Suggested Retail Price

For purposes of § 30D(f)(11)(A), “manufacturer’s suggested retail price” means the sum of: (A) the retail price of the automobile suggested by the manufacturer as described in 15 U.S.C. 1232(f)(1); and (B) the retail delivered price suggest-

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code.

² Section 4 of this notice confirms that the publication of this notice is not the publication of proposed guidance with respect to the critical mineral and battery component requirements under § 30D(e).

ed by the manufacturer for each accessory or item of optional equipment, physically attached to such automobile at the time of its delivery to the dealer, which is not included within the price of such automobile as stated pursuant to 15 U.S.C. 1232(f)(1), as described in 15 U.S.C. 1232(f)(2). This information is reported on the label that is affixed to the windshield or side window of the vehicle, as described in 15 U.S.C. 1232.

.04 Vehicle Classifications

For purposes of § 30D(f)(11)(B), the applicable limitation for each vehicle classification is as follows: (A) in the case of a van, \$80,000; (B) in the case of a sport utility vehicle, \$80,000; (C) in the case of a pickup truck, \$80,000; and (D) in the case of any other vehicle, \$55,000.

For purposes of § 30D(f)(11)(B), a vehicle's vehicle classification is to be determined consistent with the rules and definitions provided in 40 CFR 600.002 for vans, sport utility vehicles, and pickup trucks. A vehicle described in § 30D(f)(11)(B)(iv) is a vehicle that is not considered a van, sport utility vehicle, or pickup truck consistent with the rules and definitions provided in 40 CFR 600.002.

.05 Placed in Service

For purposes of the § 30D credit, a new clean vehicle is considered to be placed in service on the date the taxpayer takes possession of the vehicle.

SECTION 4. PROPOSED GUIDANCE FOR CRITICAL MINERAL AND BATTERY COMPONENT REQUIREMENTS

For purposes of § 30D(e)(3)(B), the publication of this notice is not the publication of proposed guidance with respect to the critical mineral and battery component requirements under § 30D(e) and does not trigger the applicability of the requirements. The Treasury Department and the IRS will explicitly identify when they have published proposed guidance with respect to the critical mineral and battery component requirements under § 30D(e).

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is the Office of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice, call the energy security guidance contact number at (202) 317-5254 (not a toll-free number).

Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock under Section 4501 of the Internal Revenue Code

Notice 2023-2

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue proposed regulations (forthcoming proposed regulations) addressing the application of the new excise tax on repurchases of corporate stock under § 4501 of the Internal Revenue Code (Code).¹ Section 4501 was added to a new chapter 37 of the Code by the enactment of Public Law 117-169, 136 Stat. 1818 (August 16, 2022), commonly referred to as the Inflation Reduction Act of 2022 (IRA). To provide taxpayers with interim guidance until publication of the forthcoming proposed regulations, this notice describes certain rules and procedures that the Treasury Department and the IRS intend to include in those regulations. Until the issuance of the forthcoming proposed regulations, taxpayers may rely on the rules described in section 3 of this notice.

Section 2 of this notice provides a summary of relevant law underlying the guidance set forth in section 3 of this no-

tice. Section 3 of this notice describes certain operating rules for purposes of the excise tax imposed by § 4501, including rules setting forth an exclusive list of transactions that are repurchases and rules for determining the fair market value of stock repurchased in such transactions, that the Treasury Department and the IRS intend to include in the forthcoming proposed regulations. Section 4 of this notice describes the anticipated rules for reporting and paying any liability for the excise tax imposed by § 4501. Section 5 of this notice describes the anticipated applicability date for the forthcoming proposed regulations. Section 6 of this notice requests comments on issues addressed in this notice as well as specific issues not so addressed. Section 7 of this notice provides drafting and contact information.

SECTION 2. BACKGROUND

.01 Overview.

(1) *Excise tax imposed.* Section 4501 imposes on each covered corporation (as defined in § 4501(b)) an excise tax (*stock repurchase excise tax*) equal to 1 percent of the fair market value of any stock of the corporation that is repurchased (as defined in § 4501(c)(1)) by the corporation during the taxable year. Section 4501(a).

(2) *Covered corporation.* For purposes of the stock repurchase excise tax, the term *covered corporation* means any domestic corporation the stock of which is traded on an established securities market (within the meaning of § 7704(b)(1)). Section 4501(b).

(3) *No deductions allowed.* No deduction is allowed for the payment of the stock repurchase excise tax. *See* § 275(a)(6) (as amended by § 10201(b) of the IRA to add a reference to chapter 37 of the Code, which contains § 4501).

.02 Repurchase.

(1) *Statutory scope.* Section 4501(c)(1) expressly mandates that repurchases of stock of a covered corporation to which the stock repurchase excise tax may apply include the following two types of transactions:

¹ Unless otherwise specified, all "section" or "§" references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

(a) *Section 317(b) redemptions.* The term *repurchase* means a redemption within the meaning of § 317(b) with regard to the stock of a covered corporation (§ 317(b) redemption). Section 4501(c)(1)(A).

(b) *Transactions economically similar to § 317(b) redemptions.* In addition, the term *repurchase* means any transaction determined by the Secretary of the Treasury or her delegate (Secretary) to be economically similar to a § 317(b) redemption (*economically similar transaction*). Section 4501(c)(1)(B).

(2) *Specified affiliates of covered corporations.* Section 4501(c)(2) provides a special rule that treats certain acquisitions of the stock of a covered corporation by its “specified affiliates” as repurchases during the taxable year with respect to which the stock repurchase excise tax may be imposed on the covered corporation.

(a) *Specified affiliate.* For purposes of the stock repurchase excise tax, the term *specified affiliate* means, with regard to any corporation, (i) any corporation more than 50 percent of the stock of which is owned (by vote or by value), directly or indirectly, by the corporation, and (ii) any partnership more than 50 percent of the capital interests or profits interests of which is held, directly or indirectly, by the corporation. Section 4501(c)(2)(B).

(b) *Deemed repurchase rule.* The acquisition of any stock of a covered corporation by a specified affiliate of the covered corporation, from a person who is not the covered corporation or a specified affiliate of the covered corporation, is treated as a repurchase of the stock of the covered corporation by the covered corporation for purposes of the stock repurchase excise tax. Section 4501(c)(2)(A).

.03 *Adjustment to amount taken into account under § 4501(a).*

(1) *Overview.* The stock repurchase excise tax is applied to the fair market value of any repurchases of stock by a covered corporation during its taxable year. The amount of these repurchases is reduced by (i) the fair market value of any repurchases excluded by an exception listed in § 4501(e), and (ii) the fair market value of any issuances of the covered corporation’s stock during its taxable year that, under § 4501(c)(3), offset the amount of any

repurchases of the covered corporation’s stock (*netting rule*).

(2) *Netting rule.* The netting rule provides that the amount taken into account under § 4501(a) with respect to any stock repurchased by a covered corporation is reduced by the fair market value of any stock issued by the covered corporation during the taxable year, including the fair market value of any stock issued or provided to employees of the covered corporation or employees of a specified affiliate of the covered corporation during the taxable year (whether or not the stock is issued or provided in response to the exercise of an option to purchase the stock).

.04 *Special rules for acquisitions of stock of certain foreign corporations.*

(1) *Overview.* Section 4501(d) provides special rules for acquisitions of stock of applicable foreign corporations and covered surrogate foreign corporations.

(2) *Defined terms for special rules.* For purposes of § 4501(d):

(a) *Applicable foreign corporation.* The term *applicable foreign corporation* means any foreign corporation the stock of which is traded on an established securities market. Section 4501(d)(3)(A).

(b) *Covered surrogate foreign corporation.* The term *covered surrogate foreign corporation* means any surrogate foreign corporation (as determined under § 7874(a)(2)(B) by substituting “September 20, 2021” for “March 4, 2003” each place it appears) the stock of which is traded on an established securities market, but only with respect to taxable years that include any portion of the applicable period with respect to such corporation under § 7874(d)(1). Section 4501(d)(3)(B).

(c) *Expatriated entity.* The term *expatriated entity* has the meaning given the term by § 7874(a)(2)(A).

(3) *Acquisition of stock of applicable foreign corporations.*

(a) *Scope.* Section 4501(d)(1) applies in the case of an acquisition of stock of an applicable foreign corporation by a specified affiliate of the corporation (other than a foreign corporation or a foreign partnership (unless the partnership has a domestic entity as a direct or indirect partner)) from a person that is not the applicable foreign corporation or a specified affiliate of the applicable foreign corporation.

(b) *Operative rule.* If § 4501(d)(1) applies, then for purposes of the stock repurchase excise tax—

(i) the specified affiliate is treated as a covered corporation with respect to the acquisition,

(ii) the acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation, and

(iii) the adjustment under § 4501(c)(3) (that is, the netting rule) is determined only with respect to stock issued or provided by the specified affiliate to employees of the specified affiliate.

(4) *Repurchase of stock of covered surrogate foreign corporations.*

(a) *Scope.* Section 4501(d)(2) applies in the case of—

(i) a repurchase of stock of a covered surrogate foreign corporation by the covered surrogate foreign corporation, or

(ii) an acquisition of stock of a covered surrogate foreign corporation by a specified affiliate of such corporation.

(b) *Operative rule.* If § 4501(d)(2) applies, then for purposes of the stock repurchase excise tax—

(i) the expatriated entity with respect to the covered surrogate foreign corporation is treated as a covered corporation with respect to the repurchase or acquisition,

(ii) the repurchase or acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation, and

(iii) the adjustment under § 4501(c)(3) is determined only with respect to stock issued or provided by the expatriated entity to employees of the expatriated entity.

.05 *Statutory exceptions to the application of § 4501(a).*

(1) *Overview.* Section 4501(e) lists transactions that are statutorily excepted, in whole or in part, from the application of § 4501(a) (each, a *statutory exception*).

(2) *Excepted transaction list.* As a result of the statutory exceptions, § 4501(a) does not apply to a repurchase of a covered corporation’s stock—

(a) to the extent that the repurchase is part of a reorganization (within the meaning of § 368(a)) and no gain or loss is recognized on the repurchase by the shareholder under chapter 1 of the Code by reason of the reorganization (§ 4501(e)(1)),

(b) in any case in which the stock repurchased is, or an amount of stock equal to the value of the stock repurchased is, contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan (§ 4501(e)(2)),

(c) in any case in which the total value of the stock repurchased during the taxable year does not exceed \$1,000,000 (§ 4501(e)(3)),

(d) under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business (§ 4501(e)(4)),

(e) to repurchases by a regulated investment company (*RIC*), as defined in § 851, or by a real estate investment trust (*REIT*), as defined in § 856(a) (§ 4501(e)(5)), or

(f) to the extent that the repurchase is treated as a dividend for purposes of the Code (§ 4501(e)(6)).

.06 Regulations and other guidance.

(1) *In general.* Under § 4501(f), the Secretary is authorized to prescribe such regulations and other guidance as are necessary or appropriate to carry out, and to prevent the avoidance of, the purposes of the stock repurchase excise tax.

(2) *Enumerated examples.* Regulations or other guidance described in § 4501(f) may include guidance—

(a) to prevent the abuse of the statutory exceptions,

(b) to address special classes of stock and preferred stock, and

(c) for the application of the special rules for acquisitions of stock of certain foreign corporations under § 4501(d).

.07 Applicability of stock repurchase excise tax provisions.

(1) *Repurchases.* Except to the extent that a statutory exception applies, the stock repurchase excise tax applies to repurchases after December 31, 2022 (*covered repurchases*), subject to the netting rule. *See* § 10201(d) of the IRA.

(2) *Netting rule.* In contrast to the December 31, 2022, effective date expressly provided by § 10201(d) of the IRA with regard to covered repurchases, the netting rule expressly takes into account any issuances by a covered corporation during the entirety of its taxable year. *See generally* § 4501(c)(3). Specifically, under the netting rule, the amount taken into account under § 4501(a) with respect to

any covered repurchases is “reduced by the fair market value of *any stock issued by the covered corporation during the taxable year.*” Section 4501(c)(3) (emphasis added). Therefore, solely in the case of a covered corporation that has a taxable year that both begins before January 1, 2023, and ends after December 31, 2022, that covered corporation may, solely with regard to any covered repurchases during that taxable year to which the stock repurchase excise tax applies, apply the netting rule to reduce the fair market value of the covered corporation’s covered repurchases during that taxable year by the fair market value of all issuances of its stock during the entirety of that taxable year.

SECTION 3. INTERIM GUIDANCE REGARDING THE APPLICATION OF § 4501

.01 Purpose. The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will be consistent with the guidance provided in this section 3. The Treasury Department and the IRS are issuing this interim guidance to provide clarity as to the calculation of the stock repurchase excise tax and the application of § 4501 to certain transactions and other events occurring prior to the issuance of the forthcoming proposed regulations.

.02 Defined Terms. For purposes of this notice:

(1) *Acquisitive reorganization.* The term *acquisitive reorganization* means a transaction that qualifies as a reorganization under § 368(a)(1)(A) (A reorganization) (including by reason of § 368(a)(2)(D) or § 368(a)(2)(E)), § 368(a)(1)(C), or § 368(a)(1)(D) (D reorganization) (if the D reorganization satisfies the requirements of § 354(b)(1)).

(2) *Applicable acquiror.* The term *applicable acquiror* means—

(a) a specified affiliate of a covered corporation with regard to an acquisition described in § 4501(c)(2),

(b) an applicable specified affiliate of an applicable foreign corporation with regard to an acquisition described in § 4501(d)(1),

(c) a covered surrogate foreign corporation with regard to a repurchase described in § 4501(d)(2), or

(d) a specified affiliate of a covered surrogate foreign corporation with regard to an acquisition described in § 4501(d)(2).

(3) *Applicable foreign corporation.* The term *applicable foreign corporation* has the meaning given the term in section 2.04(2)(a) of this notice.

(4) *Applicable specified affiliate.* The term *applicable specified affiliate* means a specified affiliate of an applicable foreign corporation, other than a foreign corporation or a foreign partnership (unless the partnership has a domestic entity as a direct or indirect partner).

(5) *Controlled corporation.* The term *controlled corporation* has the meaning given the term in § 355(a)(1)(A).

(6) *Covered corporation.* The term *covered corporation* has the meaning given the term in section 2.01(2) of this notice.

(7) *Covered surrogate foreign corporation.* The term *covered surrogate foreign corporation* has the meaning given the term in section 2.04(2)(b) of this notice.

(8) *De minimis exception.* The term *de minimis exception* has the meaning given the term in section 3.03(2) of this notice.

(9) *Distributing corporation.* The term *distributing corporation* has the meaning given the term in § 355(a)(1)(A).

(10) *Economically similar transaction.* The term *economically similar transaction* has the meaning given the term in section 2.02(1)(b) of this notice, as implemented in accordance with section 3.04 of this notice.

(11) *Employee.* The term *employee* means an employee as defined in § 3401(c) and § 31.3401(c)-1 of the Collection of Income Tax at Source Regulations (26 CFR part 31), or a former employee, of the covered corporation or specified affiliate, as applicable.

(12) *Employer-sponsored retirement plan.* The term *employer-sponsored retirement plan* means a retirement plan maintained by a covered corporation that is qualified under § 401(a), including an employee stock ownership plan described in § 4975(e)(7).

(13) *Established securities market.* The term *established securities market* has the meaning given the term in § 1.7704-1(b).

(14) *Expatriated entity.* The term *expatriated entity* has the meaning given the term in section 2.04(2)(c) of this notice.

(15) *Netting rule*. The term *netting rule* has the meaning given the term in section 2.03(1) of this notice, as implemented in accordance with section 3.08 of this notice.

(16) *Qualifying property exception*. The term *qualifying property exception* has the meaning given the term in section 3.07(2) of this notice.

(17) *Qualifying property repurchase*. The term *qualifying property repurchase* has the meaning given the term in section 3.07(2) of this notice.

(18) *REIT*. The term *REIT* has the meaning given the term in section 2.05(2)(e) of this notice.

(19) *Repurchase*. The term *repurchase* has the meaning given the term in section 2.02(1) of this notice, as implemented in accordance with section 3.04 of this notice.

(20) *RIC*. The term *RIC* has the meaning given the term in section 2.05(2)(e) of this notice.

(21) *Section 317(b) redemption*. The term *§ 317(b) redemption* has the meaning given the term in section 2.02(1)(a) of this notice.

(22) *Specified affiliate*. The term *specified affiliate* has the meaning given the term in section 2.02(2)(a) of this notice.

(23) *Split-off*. The term *split-off* means a distribution qualifying under § 355 (and so much of § 356 as relates to § 355) by a distributing corporation pursuant to which the shareholders of the distributing corporation exchange stock of the distributing corporation for stock of the controlled corporation and, if applicable, other property (including securities of the controlled corporation) or money.

(24) *Statutory exception*. The term *statutory exception* has the meaning given the term in section 2.05(1) of this notice, as implemented in accordance with section 3.07 of this notice.

(25) *Stock*. The term *stock* means any instrument issued by a corporation that is stock or that is treated as stock for Federal tax purposes at the time of issuance, regardless of whether the instrument is traded on an established securities market.

(26) *Stock repurchase excise tax*. The term *stock repurchase excise tax* has the meaning given the term in section 2.01(1) of this notice.

(27) *Stock repurchase excise tax base*. The term *stock repurchase excise tax base*

has the meaning given the term in section 3.03(3)(a) of this notice.

(28) *Taxable year*. The term *taxable year* has the meaning given the term in § 7701(a)(23) and may include a fiscal year (as defined in § 7701(a)(24)). See § 7701(a)(23) and (24); see also §§ 441(b) and 443.

.03 *Computation of excise tax liability*.

(1) *Imposition of tax*. Except as provided in section 3.03(2) of this notice (regarding the de minimis exception), the amount of stock repurchase excise tax imposed on a covered corporation equals the product obtained by multiplying—

(a) one percent, by

(b) the stock repurchase excise tax base of the covered corporation determined in accordance with section 3.03(3) of this notice.

(2) *De minimis exception*.

(a) *In general*. A covered corporation is not subject to the stock repurchase excise tax with regard to a taxable year if, during that taxable year, the aggregate fair market value of the covered corporation's repurchases of its stock does not exceed \$1,000,000 (*de minimis exception*).

(b) *Determination*. A determination of whether the de minimis exception applies with regard to a taxable year is made before applying—

(i) any statutory exception under section 3.07 of this notice, and

(ii) any adjustments under the netting rule under section 3.08 of this notice.

(3) *Stock repurchase excise tax base*.

(a) *In general*. With regard to a covered corporation, the term *stock repurchase excise tax base* means an amount (not less than zero) that is obtained by:

(i) Determining the aggregate fair market value of all repurchases (as determined under sections 3.04 through 3.06 of this notice) of the covered corporation's stock by the covered corporation during its taxable year,

(ii) Reducing the amount determined under section 3.03(3)(a)(i) of this notice by the fair market value of stock of the covered corporation repurchased during its taxable year to the extent any statutory exceptions apply in accordance with section 3.07 of this notice, and then

(iii) Reducing the amount determined under section 3.03(3)(a)(ii) of this notice by the aggregate fair market value of stock

of the covered corporation issued or provided by the covered corporation during its taxable year under the netting rule in accordance with section 3.08 of this notice.

(b) *Repurchases before January 1, 2023*. Repurchases by a covered corporation before January 1, 2023, as determined under section 3.06(1) of this notice, are not included in the covered corporation's stock repurchase excise tax base.

(c) *Taxable year determination*. The determinations under section 3.03(3)(a) of this notice are made separately to each covered corporation and to each taxable year of the covered corporation. Reductions under section 3.03(3)(a)(ii) or (iii) of this notice in excess of the amount determined under section 3.03(3)(a)(i) of this notice are not carried forward or backward to preceding or succeeding taxable years of a covered corporation.

.04 *Redemptions and Economically Similar Transactions*.

(1) *Overview*. This section 3.04 provides rules for determining whether a transaction is a repurchase for purposes of the stock repurchase excise tax. Section 3.04(2) of this notice provides a general rule regarding the scope of the term "repurchase." Section 3.04(3) of this notice provides an exclusive list of transactions that are treated as a § 317(b) redemption but are not repurchases. Section 3.04(4) of this notice provides (i) an exclusive list of transactions that are economically similar transactions, and (ii) a nonexclusive list of transactions that are not economically similar transactions.

(2) *Scope of repurchase*. For purposes of the stock repurchase excise tax, a *repurchase* means solely—

(a) a § 317(b) redemption, except as provided in section 3.04(3) of this notice, or

(b) an economically similar transaction described in section 3.04(4) of this notice.

(3) *Certain § 317(b) redemptions not repurchases*. This section 3.04(3) provides an exclusive list of transactions that are § 317(b) redemptions but are not repurchases.

(a) *Section 304(a)(1) transactions*.

(i) *Rule regarding deemed distributions*. If § 304(a)(1) applies to an acquisition of stock by an acquiring corporation (within the meaning of § 304(a)(1)), the

acquiring corporation's deemed distribution in redemption of its stock (resulting from the application of § 304(a)(1)) is not a repurchase.

(ii) *Scope of rule.* The rule described in section 3.04(3)(a)(i) of this notice applies to a transaction described in that section regardless of whether § 302(a) or (d) applies to the acquiring corporation's deemed distribution in redemption of its stock.

(iii) *Rule regarding deemed issuances.* For the rule addressing the treatment of any stock deemed to be issued by the acquiring corporation as a result of the application of § 304(a)(1), see section 3.08(4)(e) of this notice.

(b) *Payment by covered corporation of cash in lieu of fractional shares.* A payment by a covered corporation of cash in lieu of a fractional share is not a repurchase if—

(i) the payment is carried out as part of a transaction that qualifies as a reorganization under § 368(a) or as a distribution to which § 355 applies, or pursuant to the settlement of an option or similar financial instrument (for example, a convertible bond or convertible preferred share),

(ii) the cash received by the shareholder entitled to the fractional share is not separately bargained-for consideration (that is, the cash paid by the covered corporation in lieu of the fractional share represents a mere rounding off of the shares issued in the exchange or settlement),

(iii) the payment is carried out solely for administrative convenience (and, therefore, solely for non-tax reasons), and

(iv) the amount of cash paid to the shareholder in lieu of a fractional share does not exceed the value of one full share of the stock of the covered corporation.

(4) *Economically similar transactions.* Section 3.04(4)(a) of this notice provides an exclusive list of transactions that are economically similar transactions. Section 3.04(4)(b) of this notice provides a nonexclusive list of specific transactions that are not economically similar transactions.

(a) *Transactions that are economically similar transactions.*

(i) *Acquisitive reorganizations.* In the case of an acquisition of a target corporation that is a covered corporation or a covered surrogate foreign corporation

(as appropriate) in an acquisitive reorganization, the exchange by the target corporation shareholders of their target corporation stock as part of the acquisitive reorganization is a repurchase by the target corporation.

(ii) *Reorganizations under § 368(a)(1)(E).* In the case of a recapitalization of a covered corporation or a covered surrogate foreign corporation (each, a recapitalizing corporation) that qualifies as a reorganization under § 368(a)(1)(E) (E reorganization), an exchange by the recapitalizing corporation shareholders of their recapitalizing corporation stock as part of the E reorganization is a repurchase by the recapitalizing corporation.

(iii) *Reorganizations under § 368(a)(1)(F).* In the case of a transaction that qualifies as a reorganization under § 368(a)(1)(F) (F reorganization) in which the transferor corporation (as defined in § 1.368-2(m)(1)) is a covered corporation or a covered surrogate foreign corporation (as appropriate), the exchange by the transferor corporation shareholders of their transferor corporation stock as part of the F reorganization is a repurchase by the transferor corporation.

(iv) *Split-offs.* In the case of a split-off by a distributing corporation that is a covered corporation or a covered surrogate foreign corporation (as appropriate), the exchange by the distributing corporation shareholders of their distributing corporation stock for controlled corporation stock and, if applicable, other property (including securities of the controlled corporation) or money is a repurchase by the distributing corporation.

(v) *Complete liquidations to which both §§ 331 and 332 apply.* In the case of a complete liquidation of a covered corporation or a covered surrogate foreign corporation (as appropriate) to which §§ 331 and 332(a) respectively apply to component distributions of the complete liquidation—

(A) each distribution to which § 331 applies is a repurchase by the covered corporation or the covered surrogate foreign corporation, and

(B) the distribution to which § 332(a) applies is not a repurchase by the covered corporation or the covered surrogate foreign corporation. See section 3.04(4)(b)(i) of this notice.

(b) *Transactions that are not economically similar transactions.*

(i) *Complete liquidations.*

(A) *General rule.* Except as provided in section 3.04(4)(a)(v) of this notice, a distribution in complete liquidation of a covered corporation or a covered surrogate foreign corporation (as appropriate) to which § 331 or § 332(a) applies is not a repurchase by the covered corporation or the covered surrogate foreign corporation.

(B) *Distributions during taxable year of complete liquidation and dissolution.* If a covered corporation or a covered surrogate foreign corporation (as appropriate) completely liquidates and dissolves (within the meaning of § 1.331-1(d)(1)(ii)) during a taxable year (that is, has a final distribution in complete liquidation to which § 331 applies during that taxable year), no distribution by that covered corporation or covered surrogate foreign corporation during that taxable year is a repurchase.

(ii) *Divisive transactions under § 355 other than split-offs.* A distribution by a distributing corporation of stock of a controlled corporation qualifying under § 355 that is not a split-off is not a repurchase.

.05 *Acquisitions by Specified Affiliates, Applicable Specified Affiliates, or Covered Surrogate Foreign Corporations.*

(1) *Acquisitions of stock of a covered corporation by a specified affiliate.* If a specified affiliate of a covered corporation acquires stock of the covered corporation from a person that is not the covered corporation or another specified affiliate of the covered corporation, the acquisition is treated as a repurchase of the stock of the covered corporation by the covered corporation.

(2) *Certain acquisitions of foreign corporation stock.*

(a) *Acquisitions of applicable foreign corporation stock.*

(i) *In general.* If an applicable specified affiliate of an applicable foreign corporation acquires stock of the applicable foreign corporation from a person that is not the applicable foreign corporation or another specified affiliate of such applicable foreign corporation—

(A) the applicable specified affiliate is treated as a covered corporation with regard to the acquisition, and

(B) the acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation.

(ii) *Acquisitions and repurchases funded by applicable specified affiliates.*

(A) *General rule.* For purposes of applying § 4501(d)(1), an applicable specified affiliate is treated as acquiring stock of an applicable foreign corporation if the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions) the acquisition or repurchase of stock of the applicable foreign corporation by the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funding is undertaken for a principal purpose of avoiding the stock repurchase excise tax. For purposes of the preceding sentence, the fair market value of stock treated as acquired by the applicable specified affiliate is limited to the amount funded by the applicable specified affiliate.

(B) *Per se rule.* A principal purpose described in section 3.05(2)(a)(ii)(A) of this notice is deemed to exist if the applicable specified affiliate funds by any means, other than through distributions, the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funded entity acquires or repurchases stock of the applicable foreign corporation within two years of the funding.

(b) *Repurchases or acquisitions of covered surrogate foreign corporation stock.* If a covered surrogate foreign corporation repurchases its stock, or if a specified affiliate of the covered surrogate foreign corporation acquires stock of the covered surrogate foreign corporation—

(i) the expatriated entity with respect to the covered surrogate foreign corporation is treated as a covered corporation with respect to the repurchase or acquisition, and

(ii) the repurchase or acquisition is treated as a repurchase of stock of a covered corporation by the covered corporation.

.06 *Timing and Fair Market Value of Repurchased Stock.*

(1) *Time of repurchase.*

(a) *General rule.* Stock is treated as repurchased at the time at which, for Federal income tax purposes, ownership of the stock transfers to the covered corporation

or to the applicable acquiror (as appropriate).

(b) *Repurchase pursuant to certain economically similar transactions.* Stock repurchased in an economically similar transaction described in section 3.04(4) (a) of this notice is treated as repurchased at the time the shareholders of the covered corporation or covered surrogate foreign corporation (as appropriate) exchange their stock in the covered corporation or covered surrogate foreign corporation.

(2) *Fair market value of repurchased stock.* The fair market value of repurchased stock is the market price of the stock on the date the stock is repurchased. That is, if the price at which the repurchased stock is purchased differs from the market price of the stock on the date the stock is repurchased, the fair market value of the stock is the market price on the date the stock is repurchased.

(a) *Stock traded on an established securities market.* If repurchased stock is traded on an established securities market, the taxpayer must determine the market price of the repurchased stock by applying one of the methods provided in section 3.06(2)(a)(i) of this notice. For purposes of this section 3.06(2), repurchased stock is treated as traded on an established securities market if any stock of the same class and issue of stock is so traded, regardless of whether the shares repurchased are so traded.

(i) *Acceptable methods.* The following are acceptable methods for determining the market price of repurchased stock traded on an established securities market:

(A) The daily volume-weighted average price as determined on the date the stock is repurchased;

(B) The closing price on the date the stock is repurchased;

(C) The average of the high and low prices on the date the stock is repurchased; or

(D) The trading price at the time the stock is repurchased.

(ii) *Date of repurchase not a trading day.* For purposes of each method provided in section 3.06(2)(a)(i) of this notice, if the date the stock is repurchased is not a trading day, the date on which the market price is determined is the immediately preceding trading day.

(iii) *Consistency requirement.* The market price of repurchased stock that is traded on an established securities market must be determined by consistently applying one (but not more than one) of the methods provided in section 3.06(2)(a)(i) of this notice to all repurchases throughout the covered corporation's taxable year. That same method also must be consistently applied to determine the market price of all stock issued under the netting rule throughout the covered corporation's taxable year, other than stock issued to employees. See section 3.08(5)(a)(iii) of this notice.

(b) *Stock not traded on an established securities market.* If repurchased stock is not traded on an established securities market, the market price of the stock is determined as of the date of repurchase under the principles of § 1.409A-1(b)(5)(iv)(B)(I).

(c) *Market price of stock denominated in non-U.S. currency.* The market price of any stock that is denominated in a currency other than the United States dollar is converted into United States dollars at the spot rate (as defined in § 1.988-1(d)(1)) on the date that the stock is repurchased.

.07 *Statutory Exceptions.*

(1) *Reduction of covered corporation's stock repurchase excise tax base.* The fair market value of stock repurchased by a covered corporation in a repurchase described in this section 3.07 is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base. See section 3.03(3)(a)(ii) of this notice.

(2) *Qualifying property exception.* The fair market value of stock repurchased by a covered corporation in a repurchase described in section 3.07(2)(a) through (d) of this notice is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent that such repurchase is for property permitted by § 354 or § 355 to be received without the recognition of gain or loss (each, a *qualifying property repurchase*):

(a) A repurchase by a target corporation as part of an acquisitive reorganization;

(b) A repurchase by a covered corporation or a covered surrogate foreign corporation (as appropriate) as part of an E reorganization;

(c) A repurchase by a transferor corporation as part of an F reorganization; and

(d) A repurchase by a distributing corporation as part of a split-off (whether or not part of a D reorganization).

(3) *Stock contributions to an employer-sponsored retirement plan.*

(a) *In general.* The fair market value of stock repurchased by a covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base if the stock that is repurchased, or an amount of stock equal to the fair market value of the stock repurchased, is contributed to an employer-sponsored retirement plan.

(b) *Classes of stock contributed to an employer-sponsored retirement plan.* This section 3.07(3) applies to a covered corporation's contribution to an employer-sponsored retirement plan of a class of stock that is the same class of stock that was repurchased or a different class than the class of stock that was repurchased.

(c) *Determination of the amount of the reduction to the stock repurchase excise tax base.* The amount of the reduction under section 3.07(3)(a) of this notice is determined as follows:

(i) *Same class of stock repurchased and contributed.* If a covered corporation repurchases stock and contributes to an employer-sponsored retirement plan stock of the same class, then the amount of the reduction under section 3.07(3)(a) of this notice is equal to the aggregate fair market value of the stock repurchased during the taxable year (as determined under section 3.06(2) of this notice) divided by the number of shares repurchased multiplied by the number of shares contributed, but not in excess of the aggregate fair market value of the stock of the same class that was repurchased during the taxable year.

(ii) *Different class of stock repurchased and contributed.* If a covered corporation contributes to an employer-sponsored retirement plan stock of a different class than the class of stock that was repurchased, then the amount of the reduction under section 3.07(3)(a) of this notice is equal to the fair market value of the stock at the time that the stock is contributed to the employer-sponsored retirement plan. However, the amount of the reduction under section 3.07(3)(a) of this notice must not exceed the aggregate fair market value of stock of a different class repurchased during the taxable year.

(d) *Timing of contributions.* The reduction in the stock repurchase excise tax base, in accordance with section 3.07(3)(a) of this notice, for a taxable year applies for stock contributions made by a covered corporation to an employer-sponsored retirement plan during or on account of the covered corporation's taxable year. For purposes of the reduction in the stock repurchase excise tax base, a covered corporation may treat stock contributions to an employer-sponsored retirement plan as having been contributed in the prior taxable year if contributed by the filing deadline for the IRS Form 720, *Quarterly Federal Excise Tax Return* that is due for the first full quarter after the close of the taxpayer's taxable year (see section 4 of this notice) and on account of that taxable year within the meaning of § 404(a)(6). However, stock contributions that are treated as having been contributed in the taxable year to which the Form 720 applies cannot be treated as having been contributed for any other taxable year.

(e) *Interaction with netting rule.* Stock contributions to an employer-sponsored retirement plan under this section 3.07(3) are not treated as issued or provided to employees of the covered corporation or a specified affiliate under section 3.08 of this notice.

(4) *Repurchases by a dealer in securities in the ordinary course of business.*

(a) *In general.* Subject to section 3.07(4)(b) of this notice, the fair market value of stock repurchased by a covered corporation or an applicable acquiror (as appropriate) that is a dealer in securities (within the meaning of § 475(c)(1)) is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent the stock is acquired in the ordinary course of the dealer's business of dealing in securities.

(b) *Applicability.* The reduction described in section 3.07(4)(a) of this notice applies solely to the extent that—

(i) the dealer accounts for the stock as securities held primarily for sale to customers in the dealer's ordinary course of business;

(ii) the dealer disposes of the stock within a period of time that is consistent with the holding of the stock for sale to customers in the dealer's ordinary course

of business, taking into account the terms of the stock and the conditions and practices prevailing in the markets for similar stock during the period in which the stock is held; and

(iii) the dealer (if it is a covered corporation) does not sell or otherwise transfer the stock to an applicable acquiror, or the dealer (if it is an applicable acquiror) does not sell or otherwise transfer the stock to the covered corporation or another applicable acquiror, other than in a sale or transfer to a dealer that also satisfies the requirements of this section 3.07(4).

(5) *Repurchases by a RIC or REIT.* A repurchase by a covered corporation that is a RIC or a REIT is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base.

(6) *Repurchase treated as a dividend.*

(a) *General rule.* In accordance with section 3.07(6)(b) of this notice, the fair market value of stock repurchased by a covered corporation is a reduction for purposes of computing the covered corporation's stock repurchase excise tax base to the extent the repurchase is treated as a distribution of a dividend under § 301(c)(1) or § 356(a)(2).

(b) *Rebuttable presumption of no dividend equivalence.*

(i) *Presumption.* Subject to section 3.07(6)(b)(ii) of this notice, a repurchase to which § 302 or § 356(a) applies is presumed to be subject to § 302(a) or § 356(a)(1), respectively (and, therefore, is presumed ineligible for the exception in section 3.07(6)(a) of this notice).

(ii) *Condition to rebut presumption.* A covered corporation may rebut the presumption described in section 3.07(6)(b)(i) of this notice with regard to a specific shareholder solely by establishing with sufficient evidence that the shareholder treats the repurchase as a dividend on the shareholder's Federal income tax return.

(iii) *Sufficient evidence requirement.* A covered corporation provides sufficient evidence under section 3.07(6)(b)(ii) of this notice to establish that the shareholder treats the repurchase as a dividend on the shareholder's Federal income tax return if the covered corporation—

(A) provides information reporting, as applicable, to the redeemed shareholder, providing that the repurchase constitutes a dividend;

(B) obtains certification from the shareholder that the repurchase constitutes a redemption treated as a § 301 distribution under § 302(d), or that the repurchase has the effect of the distribution of a dividend under § 356(a)(2), including evidence that applicable withholding occurred if required;

(C) has no knowledge of facts that would indicate that the certification is incorrect; and

(D) demonstrates that the covered corporation has sufficient earnings and profits to treat either the § 301 distribution, or the receipt of money or other property under § 356, as a dividend.

.08 Netting Rule.

(1) *In general.* The stock repurchase excise tax base with regard to a taxable year of a covered corporation is reduced by the aggregate fair market value of stock of the covered corporation—

(a) issued or provided to employees of the covered corporation or employees of a specified affiliate during the covered corporation's taxable year, and

(b) issued by the covered corporation to persons other than persons described in section 3.08(1)(a) of this notice during the covered corporation's taxable year.

(2) *Time of issuance.* Stock is treated as issued or provided by a covered corporation at the time at which, for Federal income tax purposes, ownership of the stock transfers to the recipient. See section 3.08(3)(b) of this notice for additional rules regarding the time when stock is considered issued or provided to an employee.

(3) *Stock issued or provided to employees.*

(a) *Arrangements that provide stock to an employee.*

(i) *In general.* This section 3.08(3) applies to any arrangement under which stock is issued or provided to an employee of a covered corporation or of a specified affiliate as compensation for services performed as an employee. Such arrangements include transfers of stock in connection with the performance of services described in § 83, including pursuant to a nonqualified stock option, or pursuant to a stock option described in § 421.

(ii) *Stock withholding.* Stock withheld by a covered corporation or a specified affiliate to satisfy an employer's income

tax withholding obligation described in § 3402, or an employer's withholding obligation described in § 3102, is not treated as stock issued or provided to an employee by the covered corporation or specified affiliate.

(iii) *Net exercise.* Stock withheld by a covered corporation or a specified affiliate to satisfy the exercise price of a stock option is not treated as stock issued or provided by the covered corporation or specified affiliate to an employee.

(iv) *Sell-to-cover transactions.* If a third party advances to an employee an amount equal to the exercise price of a stock option or pays the exercise price of the stock option on behalf of the employee, any stock transferred by the covered corporation or specified affiliate to the employee or the third party upon exercise of the option is treated as stock issued or provided to the employee. Similarly, if a third party advances to the employee an amount equal to the withholding obligation described in § 3402 or § 3102 or pays an amount equal to that withholding obligation to the covered corporation or specified affiliate on behalf of an employee, any stock transferred by the covered corporation or specified affiliate to the employee or the third party is treated as stock issued or provided to the employee.

(b) *Time when stock is considered issued or provided to an employee.*

(i) *In general.* Stock is issued or provided by a covered corporation or a specified affiliate to an employee as of the date that the employee is treated as the beneficial owner of the stock for Federal income tax purposes. In general, an employee is treated as the beneficial owner of the stock when the stock is transferred by the covered corporation (or the specified affiliate) to the employee and the stock is substantially vested within the meaning of § 1.83-1(b). Thus, stock transferred pursuant to a vested stock award or restricted stock unit is issued or provided when the covered corporation or specified affiliate initiates payment of the stock. Stock transferred that is not substantially vested within the meaning of § 1.83-3(b) is not issued or provided to the employee until it vests, except as provided in section 3.08(3)(b)(iii) of this notice.

(ii) *Stock options and stock appreciation rights.* Stock transferred to an em-

ployee pursuant to an option described in § 1.83-7 or § 421 or a stock appreciation right is issued or provided to the employee as of the date the employee exercises the option or stock appreciation right.

(iii) *Stock on which a § 83(b) election is made.* Stock that is transferred to an employee that is not substantially vested within the meaning of § 1.83-3(b) but on which the employee makes a valid election under § 83(b) is treated as issued or provided to the employee as of the transfer date.

(c) *Fair market value of stock issued or provided to an employee.* The fair market value of stock issued or provided to an employee is the fair market value of the stock, as determined under § 83, as of the date the stock is issued or provided to the employee, as described in section 3.08(3)(b) of this notice.

(4) *Issuances that are disregarded for purposes of applying the netting rule.*

(a) *Overview.* This section 3.08(4) lists the sole circumstances in which an issuance of stock is disregarded for purposes of the netting rule.

(b) *Distributions by a covered corporation of its own stock.* Stock of a covered corporation distributed by the covered corporation to its shareholders with respect to its stock is not treated as issued.

(c) *Issuances to a specified affiliate.* Stock issued by a covered corporation to a specified affiliate of the covered corporation is not treated as issued.

(d) *No double benefit for issuances that are part of a transaction to which the qualifying property exception applies.* Stock issued as part of a transaction qualifying as a reorganization under § 368(a) or a distribution under § 355 is not treated as issued by the issuing corporation if—

(i) the stock constitutes property permitted to be received under § 354 or § 355 without the recognition of gain,

(ii) the stock is used by a covered corporation to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(i), (ii), (iii), or (iv) of this notice, and

(iii) the repurchase is not included in the covered corporation's stock repurchase excise tax base because that repurchase is a qualifying property repurchase.

(e) *Deemed issuances under § 304(a)(1).* Any stock treated as issued by the ac-

quiring corporation by reason of the application of § 304(a)(1) to a transaction (as more fully described in section 3.04(3)(a) of this notice) is not treated as issued.

(f) *Deemed issuance of a fractional share.* Any fractional share deemed to be issued for Federal income tax purposes (in a payment described in section 3.04(3)(b) of this notice) is not treated as issued.

(g) *Issuance by a covered corporation that is a dealer in securities.* Any stock issued by a covered corporation that is a dealer in securities is not treated as issued to the extent the stock is issued, or otherwise is used to satisfy obligations to customers arising, in the ordinary course of the dealer's (or an applicable acquiror's) business of dealing in securities.

(h) *Issuance by the target corporation in a transaction qualifying under § 368(a)(2)(E).* Any target corporation stock that is issued by the target corporation to the merged corporation (within the meaning of § 368(a)(2)(E)) in exchange for consideration that includes the stock of the controlling corporation (within the meaning of § 368(a)(2)(E)) in a transaction qualifying as an A reorganization by reason of § 368(a)(2)(E) is not treated as issued.

(5) *Fair market value of issued stock.* With respect to the issuance of stock that is not subject to section 3.08(3)(c) of this notice, the fair market value of stock issued is the market price of the stock on the date the stock is issued.

(a) *Stock traded on an established securities market.* If stock issued is traded on an established securities market, the taxpayer must determine the market price of the issued stock by applying one of the methods provided in section 3.08(5)(a)(i) of this notice.

(i) *Acceptable methods.* The following are acceptable methods for determining the market price of stock issued that is traded on an established securities market:

(A) The daily volume-weighted average price as determined on the date the stock is issued;

(B) The closing price on the date the stock is issued;

(C) The average of the high and low prices on the date the stock is issued; or

(D) The trading price at the time the stock is issued.

(ii) *Date of issuance not a trading day.* For purposes of each method provided in

section 3.08(5)(a)(i) of this notice, if the date the stock is issued is not a trading day, the date on which the market price is determined is the immediately preceding trading day.

(iii) *Consistency requirement.* The market price of stock issued that is traded on an established securities market must be determined by consistently applying one (but not more than one) of the methods provided in section 3.08(5)(a)(i) of this notice to all stock issued throughout the covered corporation's taxable year. That same method also must be consistently applied to determine the market price of all stock repurchased throughout the covered corporation's taxable year. See section 3.06(2)(a)(iii) of this notice.

(b) *Stock not traded on an established securities market.* If stock issued is not traded on an established securities market, the market price of the stock is determined as of the date the stock is issued under the principles of § 1.409A-1(b)(5)(iv)(B)(I).

(c) *Market price of stock denominated in non-U.S. currency.* The market price of any stock that is denominated in a currency other than the United States dollar is converted into United States dollars at the spot rate (as defined in § 1.988-1(d)(1)) on the date that the stock is issued.

.09 *Examples.* The following examples illustrate the application of this section 3. For purposes of the following examples, unless otherwise stated: Each of Corporation X and unrelated Target is a covered corporation that is organized in State A and is a calendar-year taxpayer; Corporation X's and Target's only outstanding stock is a single class of common stock that is traded on an established securities market; any shareholder whose stock is redeemed in a § 317(b) redemption qualifies for sale or exchange treatment under § 302(a); and the receipt of money or other property by any shareholder whose stock is repurchased in an acquisitive reorganization or an E reorganization is not treated as having the effect of a distribution of a dividend under § 356(a)(2).

(1) *Example 1: Redemption of preferred stock—*(a) *Facts.* Corporation X has outstanding common stock that is traded on an established securities market, as well as mandatorily redeemable preferred stock that is not traded on an established securities market. The preferred stock is stock for Federal tax purposes. On January 1, 2023, Corporation X redeems the preferred stock pursuant to its terms.

(b) *Analysis.* The redemption by Corporation X of its mandatorily redeemable preferred stock is a repurchase because (i) Corporation X redeemed an instrument that is stock for Federal tax purposes (that is, mandatorily redeemable preferred stock issued by Corporation X), and (ii) the redemption by Corporation X is a § 317(b) redemption. See section 3.04(2)(a) of this notice.

(2) *Example 2: Valuation of repurchase—*(a) *Facts.* On April 15, 2023, when Corporation X's common stock is trading at \$0.70x per share, Corporation X purchases 50x shares of its common stock for \$35x from one of its shareholders.

(b) *Analysis.* Corporation X's purchase of 50x shares of Corporation X common stock is a repurchase because the transaction is a § 317(b) redemption. See section 3.04(2)(a) of this notice. For purposes of calculating Corporation X's stock repurchase excise tax base, the fair market value of the 50x shares of common stock repurchased on April 15, 2023, is the aggregate market price of those shares on that repurchase date, or \$35x ($\$0.70x \text{ per share} \times 50x \text{ shares} = \$35x$). See section 3.06(2)(a) of this notice. Accordingly, the repurchase by Corporation X increases its stock repurchase excise tax base for the 2023 taxable year by \$35x.

(c) *Application of netting rule.* The facts are the same as in section 3.09(2)(a) of this notice (this Example 2), except that, on August 1, 2023, Corporation X issues 20x shares of its common stock to an unrelated party, at which time ownership of the stock transfers to the unrelated party for Federal income tax purposes. On that date, the common stock of Corporation X is trading at \$0.50x per share. For purposes of calculating Corporation X's stock repurchase excise tax base, Corporation X is treated as issuing its 20x shares of common stock on August 1, 2023 (the date on which ownership of the stock transfers to the recipient for Federal income tax purposes). See section 3.08(2) of this notice. In addition, the fair market value of that issued stock is its aggregate market price on the date of issuance by Corporation X, or \$50x ($\$0.50x \text{ per share} \times 20x \text{ shares} = \$10x$). See sections 3.03(3)(a) and 3.08(5)(a) of this notice. Accordingly, the net increase in Corporation X's stock repurchase excise tax base for its 2023 taxable year is \$25x ($\$35x \text{ repurchase} - \$10x \text{ issuance} = \$25x$). See section 3.08(1) of this notice.

(3) *Example 3: Acquisition partially funded by the target corporation—*(a) *Facts.* On May 30, 2023, Corporation X acquires all of Target's outstanding stock (Target Stock Acquisition). To effectuate the Target Stock Acquisition, Corporation X causes the following transaction steps to occur: (i) Corporation X contributes \$40x to a newly formed corporation (Merger Sub); and (ii) Merger Sub merges into Target, with Target surviving the merger (Subsidiary Merger). At the time of the Subsidiary Merger, the stock of Target has an aggregate fair market value of \$100x. In the Subsidiary Merger, Target's shareholders exchange all their Target stock for \$100x of cash, of which \$60x is funded by Target and \$40x is funded by Corporation X. For Federal income tax purposes, the transitory existence of Merger Sub is disregarded, and Target is treated as if Target redeemed 60% of its outstanding stock for \$60x as part of the Subsidiary Merger. (This treatment results from the fact that Target funded \$60x of the consideration re-

ceived by Target's shareholders in exchange for their Target stock.)

(b) *Analysis.* Target's redemption of 60% of its outstanding stock is a § 317(b) redemption. In addition, Target's redemption is not included in the exclusive list of transactions under section 3.04(3) of this notice that are treated as a § 317(b) redemption but are not a repurchase. Accordingly, the redemption is a repurchase. See section 3.04(2)(a) of this notice. Therefore, as a result of the Target Stock Acquisition, Target's stock repurchase excise tax base for its 2023 taxable year is increased by \$60x. See section 3.03(3)(a) of this notice.

(4) *Example 4: Leveraged buyout—(a) Facts.* The facts are the same as in section 3.09(3)(a) of this notice (*Example 3*), except that \$60x of the consideration received by Target's shareholders in exchange for their Target stock is funded by a \$60x loan to Merger Sub from an unrelated lender (Loan). In the Subsidiary Merger, Target assumes Merger Sub's obligation on the \$60x Loan. As a result of the disregarded transitory existence of Merger Sub, the Target Stock Acquisition is treated for Federal income tax purposes as though Target (i) directly borrowed \$60x from the unrelated lender, and then (ii) used the Loan proceeds to redeem \$60x of its stock from the Target shareholders.

(b) *Analysis.* The analysis and Federal income tax consequences are the same as in *Example 3*.

(5) *Example 5: Pro rata stock split—(a) Facts.* On October 1, 2023, Corporation X distributes three shares of Corporation X common stock with respect to each existing share of its outstanding common stock (Corporation X Stock Split).

(b) *Analysis.* The common stock distributed by Corporation X to its shareholders through the Corporation X Stock Split is not an issuance because Corporation X distributed the stock to its shareholders with respect to its outstanding common stock. See section 3.08(4)(b) of this notice. Therefore, the stock distributed by Corporation X is not taken into account for purposes of the netting rule. See section 3.08(4)(a) of this notice (disregarding such types of issuances). Accordingly, Corporation X's stock repurchase excise tax base for its 2023 taxable year is not reduced by the Corporation X Stock Split.

(6) *Example 6: Acquisition of a target corporation in an acquisitive reorganization—(a) Facts.* On October 1, 2023, Target merges into Corporation X (Target Merger). The Target Merger qualifies as an A reorganization. On the date of the Target Merger, the fair market value of Target's outstanding stock is \$100x. In the Target Merger, Target's shareholders exchange \$60x of their Target stock for Corporation X common stock, and \$40x of their Target stock for \$40x of cash.

(b) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Target shareholders of their Target stock for the consideration received in the Target Merger is a repurchase by Target because that exchange is an economically similar transaction. See section 3.04(4)(a)(i) of this notice. This repurchase occurs on October 1, 2023 (that is, the date on which the Target shareholders exchange their Target shares as part of the Target Merger). See section 3.06(1)(b) of this notice. The amount of this repurchase by Target is \$100x, which equals the aggregate fair market value of the Target stock at

the time that stock is exchanged by the Target shareholders as part of the Target Merger (that is, October 1, 2023). See section 3.06(2)(a) of this notice.

(c) *Analysis regarding impact of Target Merger on Target's stock repurchase excise tax base.* Target's stock repurchase excise tax base for its 2023 taxable year is initially increased by \$100x on account of the Target Merger. Under the qualifying property exception, the fair market value of the Target stock exchanged by the Target shareholders for Corporation X stock in the Target Merger (that is, \$60x of Target stock) is a qualifying property repurchase that reduces Target's stock repurchase excise tax base. See sections 3.03(3)(a) and 3.07(2)(a) of this notice (regarding acquisitive reorganizations). However, the fair market value of the Target stock exchanged by the Target shareholders for the \$40x of cash in the Target Merger does not qualify for the qualifying property exception. See sections 3.03(3)(a) and 3.07(2)(a) of this notice. Therefore, Target's stock repurchase excise tax base for its 2023 taxable year is increased by \$40x (\$100x repurchase - \$60x exception = \$40x).

(d) *Analysis regarding Corporation X's stock repurchase excise tax base.* Corporation X's transfer of Corporation X stock to Target in the Target Merger is not an issuance for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the qualifying property exception applies. See generally section 3.08(4)(d) of this notice. Specifically, Corporation X's transfer of Corporation X stock to Target is not an issuance for purposes of the netting rule because (i) the Corporation X stock constitutes property permitted to be received under § 354 without the recognition of gain, (ii) the Corporation X stock is used by a covered corporation (that is, Target) to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(i) of this notice, and (iii) the repurchase by Target is not included in Target's stock repurchase excise tax base because it is a qualifying property repurchase. See section 3.08(4)(d) of this notice. Therefore, Corporation X does not take into account any of the \$60x of its stock transferred to Target in the Target Merger to reduce its stock repurchase excise tax base for Corporation X's 2023 taxable year. See section 3.08(4)(a) of this notice (disregarding such types of issuances).

(7) *Example 7: Cash paid in lieu of fractional shares—(a) Facts.* The facts are the same as in section 3.09(6)(a) of this notice (*Example 6*). Additionally, the exchange ratio in the Target Merger is 1.25 shares of Corporation X stock for each share of Target stock. As part of the Target Merger, Shareholder A, who owns two shares of Target stock, receives two shares of Corporation X stock as well as additional cash in lieu of a 0.5 fractional share in Corporation X. The payment by Corporation X to Shareholder A of cash in lieu of a fractional share of Corporation X stock (i) was not separately bargained-for consideration (that is, the cash paid by Corporation X in lieu of a fractional Corporation X share represented a mere rounding off of the two Corporation X shares issued in the exchange), (ii) was carried out solely due to administrative necessity (and therefore, solely for non-tax reasons), and (iii) was for an amount of cash with regard to a fractional share of Corporation X stock that did not exceed the value of one share.

(b) *Analysis.* The payment by Corporation X of cash to Shareholder A in lieu of a fractional share of Corporation X stock is treated for Federal income tax purposes as though the 0.5 fractional share were (i) distributed by Corporation X to Shareholder A as part of the Target Merger, and then (ii) redeemed by Corporation X for cash. Corporation X's deemed redemption of the fractional share treated as received by Shareholder A in the Target Merger is not a repurchase because, in addition to the facts described in section 3.09(7)(a) of this notice (this *Example 7*), the payment of cash by Corporation X is carried out as part of a transaction that qualifies as an acquisitive reorganization (that is, the Target Merger). See section 3.04(3)(b) of this notice. In addition, Corporation X's deemed issuance of the fractional share to Shareholder A is not taken into account for purposes of the netting rule. See section 3.08(4)(f) of this notice.

(8) *Example 8: Two-step asset acquisition—(a) Facts.* Corporation X acquires the assets of Target through the following transactions, each of which occurs pursuant to an integrated plan to effect the acquisition. First, on September 30, 2023, Corporation X contributes \$60x of Corporation X stock and \$40x of cash to a newly formed subsidiary (Merger Sub). Second, on October 1, 2023, Merger Sub merges into Target in a statutory merger, with Target surviving (Reverse Merger). Third, on October 15, 2023, Target merges into Corporation X in a statutory merger (Upstream Merger). On the date of the Reverse Merger, the fair market value of Target's outstanding stock is \$100x. In the Reverse Merger, \$60x of Target stock is exchanged for Corporation X stock, and \$40x of Target stock is exchanged for \$40x of cash. For Federal income tax purposes, the Reverse Merger and the Upstream Merger are integrated into a single statutory merger of Target into Acquiring that qualifies as an A reorganization.

(b) *Analysis.* The analysis is the same as in section 3.09(6) of this notice (*Example 6*).

(9) *Example 9: E reorganization—(a) Facts.* On November 1, 2023, Corporation X issues new common stock, with an aggregate fair market value of \$100x (New Common Stock), to Corporation X's shareholders in exchange for their outstanding common stock in Corporation X (Old Common Stock). The exchange (Recapitalization) qualifies as an E reorganization. At the time of the Recapitalization, the fair market value of Corporation X's outstanding common stock is \$100x.

(b) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Corporation X shareholders of their Corporation X stock (that is, the Old Common Stock) for New Common Stock is a repurchase by Corporation X because that exchange is an economically similar transaction. See section 3.04(4)(a)(ii) of this notice. This repurchase occurs on November 1, 2023 (that is, the date on which the Target shareholders exchange their Old Common Stock as part of the Recapitalization). See section 3.06(1)(b) of this notice. The amount of this repurchase by Corporation X is \$100x, which equals the aggregate fair market value of the Old Common Stock at the time that stock is exchanged by the Corporation X shareholders as part of the Recapitalization (that is, November 1, 2023). See section 3.06(2) of this notice.

(c) *Analysis regarding impact of repurchase of Old Common Stock on Corporation X's stock repurchase excise tax base.* Corporation X's stock repurchase excise tax base for its 2023 taxable year is initially increased by \$100x on account of the Recapitalization. Under the qualifying property exception, the fair market value of the Old Common Stock exchanged by the Corporation X shareholders for New Common Stock in the Recapitalization (that is, \$100x of Old Common Stock) is a qualifying property repurchase that reduces Corporation X's stock repurchase excise tax base. See sections 3.03(3)(a) and 3.07(2)(b) of this notice (regarding E reorganizations). Consequently, because all the Old Common Stock was exchanged by the Corporation X shareholders for New Common Stock, the Recapitalization does not increase Corporation X's stock repurchase excise tax base for its 2023 taxable year (\$100x repurchase - \$100x exception = \$0).

(d) *Analysis regarding impact of issuance of New Common Stock on Corporation X's stock repurchase excise tax base.* Corporation X's issuance of the New Common Stock is not an issuance for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the qualifying property exception applies. See generally section 3.08(4)(d) of this notice. Specifically, Corporation X's issuance of its New Common Stock to Corporation X's shareholders is not an issuance for purposes of the netting rule because (i) the New Common Stock constitutes property permitted to be received under § 354 without the recognition of gain, (ii) the New Common Stock is used by a covered corporation (that is, Corporation X) to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(ii) of this notice, and (iii) the repurchase by Corporation X is not included in Corporation X's stock repurchase excise tax base for its 2023 taxable year because it is a qualifying property repurchase. See section 3.08(4)(d) of this notice. Therefore, Corporation X does not take into account any of the \$100x of New Common Stock issued to Corporation X's shareholders to reduce its stock repurchase excise tax base for Corporation X's 2023 taxable year. See section 3.08(4)(a) of this notice (disregarding such types of issuances).

(10) *Example 10: F reorganization—(a) Facts.* In order to reorganize under the laws of State B, on November 15, 2023, Corporation X forms Corporation Y, a State B corporation, and merges into Corporation Y (Corporation X Merger). The Corporation X Merger qualifies as an F Reorganization. On the date of the Corporation X Merger, the fair market value of Corporation X's stock is \$100x. Shareholder A owns \$25x of Corporation X's outstanding stock. In the Corporation X Merger, Shareholder A transfers its \$25x of Corporation X stock to Corporation X in exchange for \$25x of cash, which is treated for Federal income tax purposes as an unrelated, separate transaction from the F Reorganization to which § 302(a) applies (Shareholder A Redemption). See § 1.368-2(m)(3)(iii). The remaining Corporation X shareholders exchange their Corporation X stock for Corporation Y stock as part of the F Reorganization.

(b) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by Shareholder A of their Corporation X stock is a repurchase by Corporation X in the amount of \$25x because it is a

§ 317(b) redemption. See section 3.04(2)(a) of this notice. In addition, the exchange by Corporation X's other shareholders of their Corporation X stock for Corporation Y stock is a repurchase by Corporation X in the amount of \$75x because that exchange is an economically similar transaction. See section 3.04(4)(a)(iii) of this notice. These repurchases occur on November 15, 2023 (that is, the date on which the Corporation X shareholders transfer their Corporation X stock to Corporation X as part of the Corporation X Merger). See section 3.06(1)(a) and (b) of this notice. The total amount of these repurchases by Corporation X is \$100x, which equals the sum of (i) the fair market value of the Corporation X stock redeemed in the Shareholder A Redemption on the date of the redemption, and (ii) the aggregate fair market value of the Corporation X stock at the time that stock is exchanged by the Corporation X shareholders as part of the F Reorganization (that is, November 15, 2023). See section 3.06(2)(a) of this notice.

(c) *Analysis regarding impact of Shareholder A Redemption and F Reorganization on Corporation X's stock repurchase excise tax base.* Corporation X's stock repurchase excise tax base for its 2023 taxable year is initially increased by \$100x on account of the Shareholder A Redemption and F Reorganization. Under the qualifying property exception, the fair market value of the Corporation X stock exchanged by the Corporation X shareholders for Corporation Y stock in the F Reorganization (that is, \$75x of Corporation X stock) is a qualifying property repurchase that reduces Corporation X's stock repurchase excise tax base. See sections 3.03(3)(a) and 3.07(2)(c) of this notice. Accordingly, Corporation X's stock repurchase excise tax base for its 2023 taxable year is increased by \$25x (\$25x repurchase + \$75x repurchase - \$75x exception) = \$25x.

(d) *Analysis regarding Corporation Y's stock repurchase excise tax base.* Corporation Y's transfer of the \$75x of its stock to Corporation X in the Corporation X Merger is not an issuance for purposes of the netting rule because Corporation Y's issuance of that stock is part of a transaction to which the qualifying property exception applies. See generally section 3.08(4)(d) of this notice. Specifically, Corporation Y's transfer of its stock to Corporation X is not an issuance for purposes of the netting rule because (i) the Corporation Y stock constitutes property permitted to be received under § 354 without the recognition of gain, (ii) the Corporation Y stock is used by a covered corporation (that is, Corporation X) to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(iii) of this notice, and (iii) the repurchase by Corporation X is not included in Corporation X's stock repurchase excise tax base for its 2023 taxable year because it is a qualifying property repurchase. See section 3.08(4)(d) of this notice. Therefore, Corporation Y does not take into account any of the \$75x of its stock transferred to Corporation X to reduce its stock repurchase excise tax base for Corporation Y's 2023 taxable year. See section 3.08(4)(a) of this notice (disregarding such types of issuances).

(11) *Example 11: Section 355 split-off—(a) Facts.* A covered corporation (Distributing) has outstanding common stock that is traded on an established securities market. Distributing owns all the stock of a preexisting subsidiary (Controlled). On

December 1, 2023, Distributing distributes all the stock of Controlled and \$20x of cash to certain of its shareholders (Participating Shareholders) in exchange for \$100x of Distributing stock in a split-off (Participating Shareholders Split-Off). On the date of the Participating Shareholders Split-Off, the Distributing stock has a fair market value of \$100x.

(b) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Participating Shareholders of their Distributing stock for the \$80x of Controlled stock and \$20x of cash in the Participating Shareholders Split-Off is a repurchase by Distributing because that exchange is an economically similar transaction. See section 3.04(4)(a)(iv) of this notice. This repurchase occurs on December 1, 2023 (that is, the date on which the Participating Shareholders exchange their Distributing shares as part of the Participating Shareholders Split-Off). See section 3.06(1)(b) of this notice. The amount of this repurchase by Distributing is \$100x, which equals the aggregate fair market value of the Distributing stock at the time that stock is exchanged by the Participating Shareholders in the Participating Shareholders Split-Off (that is, December 1, 2023). See section 3.06(2)(a) of this notice.

(c) *Analysis regarding impact of Distribution on Distributing's stock repurchase excise tax base.* Distributing's stock repurchase excise tax base for its 2023 taxable year is initially \$100x on account of the Participating Shareholders Split-Off. However, under the qualifying property exception, the fair market value of the Distributing stock exchanged by the Participating Shareholders for Controlled stock in the Participating Shareholders Split-Off (that is, \$80x of Distributing Stock) is a qualifying property repurchase that reduces Distributing's stock repurchase excise tax base. See sections 3.03(3)(a) and 3.07(2)(d) of this notice. However, the fair market value of the Distributing stock exchanged by the Participating Shareholders for the \$20x of cash in the Participating Shareholders Split-Off does not qualify for the qualifying property exception. See sections 3.03(3)(a) and 3.07(2)(d) of this notice. Therefore, Distributing's stock repurchase excise tax base for its 2023 taxable year is increased by \$20x.

(12) *Example 12: Section 355 split-off as part of a D reorganization—(a) Facts.* The facts are the same as in section 3.09(11)(a) of this notice (Example 11), except that the Participating Shareholders Split-Off is carried out as part of a transaction qualifying as a D reorganization in which Distributing transfers assets to Controlled.

(b) *General analysis.* Except as provided in section 3.09(12)(c) of this notice, the analysis and Federal income tax consequences are the same as in section 3.09(11) of this notice (Example 11).

(c) *Analysis regarding Controlled's stock repurchase excise tax base.* Controlled's transfer of the \$80x of its stock to Distributing in the Participating Shareholders Split-Off is not an issuance for purposes of the netting rule because Controlled's issuance of that stock is part of a transaction to which the qualifying property exception applies. See generally section 3.08(4)(d) of this notice. Specifically, Controlled's transfer of its stock to Distributing is not an issuance for purposes of the netting rule because (i) the Controlled stock constitutes property permitted to be received under § 355 without the recognition

of gain, (ii) the Controlled stock is used by a covered corporation (that is, Distributing) to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(iv) of this notice, and (iii) the repurchase by Distributing is not included in Distributing's stock repurchase excise tax base for its 2023 taxable year because it is a qualifying property repurchase. See section 3.08(4)(d) of this notice. Therefore, Controlled does not take into account any of the \$80x of its stock transferred to Distributing to reduce Controlled's stock repurchase excise tax base for Controlled's 2023 taxable year. See section 3.08(4)(a) of this notice (disregarding such types of issuances).

(13) *Example 13: Spin-off—(a) Facts.* The facts are the same as in section 3.09(11)(a) of this notice (*Example 11*), except that Distributing distributes the Controlled stock to its shareholders pro rata without the shareholders exchanging any Distributing stock (Spin-Off).

(b) *Analysis.* The Spin-Off is not an economically similar transaction. See section 3.04(4)(b)(ii) of this notice. Therefore, the Spin-Off is not a repurchase by Distributing.

(14) *Example 14: Section 355 spin-off as part of a D reorganization—(a) Facts.* The facts are the same as in section 3.09(13)(a) of this notice (*Example 13*), except that the Spin-Off is carried out as part of a transaction qualifying as a D reorganization.

(b) *Analysis.* The analysis and Federal income tax consequences are the same as in section 3.09(13) of this notice (*Example 13*).

(15) *Example 15: Repurchase pursuant to an accelerated share repurchase agreement—(a) Facts.* On October 10, 2022, Corporation X entered into an accelerated share repurchase (ASR) agreement with an investment bank (Bank). Under the terms of the ASR agreement, Bank agrees to deliver a number of shares of Corporation X stock to Corporation X during the term of the ASR, in an amount determined by reference to the price of Corporation X stock on specified days during the term of the ASR. Pursuant to the terms of the ASR agreement, Corporation X paid Bank a prepayment amount. Bank borrowed 80x shares of Corporation X stock on the open market. Pursuant to the terms of the ASR agreement, Bank then delivered 80x shares of Corporation X stock to Corporation X on October 12, 2022. On final settlement of the ASR, Bank may be required to deliver additional shares of Corporation X stock to Corporation X or Corporation X may be required to make a payment to Bank. The terms of the ASR agreement and the facts and circumstances cause ownership of the 80x shares to transfer from Bank to Corporation X for Federal income tax purposes at the time of delivery (that is, October 12, 2022). The agreement will settle in 2023. On February 1, 2023, Bank delivers an additional 20x shares to Corporation X in final settlement of the ASR agreement. For Federal income tax purposes, ownership of those 20x shares is treated as transferring from Bank to Corporation X at the time of delivery (that is, February 1, 2023).

(b) *Analysis.* Corporation X is treated as repurchasing 80x shares of Corporation X stock on October 12, 2022 (that is, the date on which ownership of the 80x shares delivered by Bank transferred from Bank to Corporation X for Federal income tax purposes). See section 3.06(1)(a) of this notice. However,

the repurchase by Corporation X of the 80x shares of Corporation X stock does not increase Corporation X's stock repurchase excise tax base for its 2023 taxable year because the repurchase occurred prior to January 1, 2023. See section 3.03(3)(b) of this notice; see also § 10201(d) of the IRA (providing that the stock repurchase excise tax applies to repurchases after December 31, 2022). The delivery by Bank to Corporation X of 20x shares of Corporation X stock on February 1, 2023, constitutes a repurchase because, for Federal income tax purposes, the terms of the ASR agreement and the facts and circumstances cause ownership of those shares to transfer from Bank to Corporation X on that date. See section 3.06(1)(a) of this notice. Therefore, the repurchase by Corporation X of those 20x shares of Corporation X stock increases Corporation X's stock repurchase excise tax base for its 2023 taxable year.

(16) *Example 16: Distribution in complete liquidation of a covered corporation—(a) Facts.* Corporation X adopts a plan of complete liquidation that becomes effective on March 1, 2023 (Corporation X Liquidation). Corporation X has 100x shares of common stock outstanding. On April 1, 2023, all shareholders of Corporation X receive a liquidating distribution by Corporation X in full payment for their Corporation X common stock. At the time at which Corporation X distributes all of its corporate assets to its shareholders in complete liquidation (that is, April 1, 2023), Corporation X stock trades at \$1x per share. Each distribution in complete liquidation is subject to § 331.

(b) *Analysis.* A distribution in complete liquidation of a covered corporation (that is, Corporation X) to which § 331 (but not § 332(a)) applies is not a repurchase by the covered corporation. See section 3.04(4)(b)(i) of this notice. Therefore, none of the distributions by Corporation X in complete liquidation is a repurchase by Corporation X, and Corporation X's stock repurchase excise tax for its 2023 taxable year is not increased as a result of the Corporation X Liquidation.

(17) *Example 17: Complete liquidation of a covered corporation to which both §§ 331 and 332(a) apply—(a) Facts.* The facts are the same as in section 3.09(16)(a) of this notice (*Example 16*), except that one of Corporation X's shareholders is a corporation (Corporation Z). As of the date of adoption of the plan of liquidation of Corporation X (that is March 1, 2023), Corporation Z has continued to be at all times until the receipt of the Corporation X liquidating distribution the owner of 80x shares of Corporation X common stock. In other words, Corporation Z has continued to be at all times until the receipt of the Corporation X liquidating distribution the owner of stock in Corporation X meeting the requirements of § 1504(a)(2) (that is, Corporation Z is an 80-percent distributee within the meaning of § 337(c)). Therefore, the liquidating distribution by Corporation X to Corporation Z as part of the Corporation X Liquidation qualifies as a liquidation under § 332(a). The liquidating distributions by Corporation X to the other shareholders described in section 3.09(16)(a) of this notice (*Example 16*) are distributions in liquidation subject to § 331.

(b) *Analysis.* In the case of a complete liquidation of a covered corporation, if §§ 331 and 332(a), respectively, apply to component distributions of

the complete liquidation, (i) a distribution to which § 331 applies is a repurchase by the covered corporation, and (ii) the distribution to which § 332(a) applies is not a repurchase by the covered corporation. See section 3.04(4)(a)(v) of this notice. Therefore, as a result of the component liquidating distributions of the Corporation X Liquidation to which § 331 applies, Corporation X repurchased 20x shares of its stock on April 1, 2023. Accordingly, the Corporation X Liquidation results in a \$20x increase in Corporation X's stock repurchase excise tax base for its 2023 taxable year because the fair market value of Corporation X's stock at the time of repurchase (that is, April 1, 2023) was \$1x per share (20x shares x \$1x = \$20x). See section 3.06(2)(a) of this notice.

(18) *Example 18: Acquisition by disregarded entity—(a) Facts.* Corporation X owns all the interests in LLC, a domestic limited liability company that is disregarded as an entity separate from its owner for Federal tax purposes (disregarded entity) under § 301.7701-3 of the Procedure and Administration Regulations (26 CFR part 301). On May 31, 2023, LLC purchases shares of Corporation X's stock for cash from an unrelated shareholder.

(b) *Analysis.* Because LLC is a disregarded entity, the May 31, 2023, acquisition of Corporation X stock is treated as an acquisition by Corporation X. Accordingly, the acquisition is a § 317(b) redemption and is therefore a repurchase. See section 3.04(2) of this notice. Section 301.7701-2(c)(2)(v) (treating disregarded entities as corporations for purposes of certain excise taxes) does not apply to treat LLC as a corporation because § 4501 is not described in § 301.7701-2(c)(2)(v)(A).

(19) *Example 19: Acquisitive reorganization qualifying under § 368(a)(2)(E)—(a) Facts.* On October 1, 2023, Corporation X acquires all of Target's outstanding stock (Target Stock Acquisition). To effectuate the Target Stock Acquisition, Corporation X causes the following transaction steps to occur: (i) Corporation X contributes \$80x of Corporation X common stock and \$20x of cash (Merger Consideration) to a newly formed corporation (Merger Sub); and (ii) Merger Sub merges into Target in a statutory merger, with Target surviving (Reverse Merger). The Reverse Merger qualifies as an A reorganization by reason of § 368(a)(2)(E). On the date of the Reverse Merger, the fair market value of Target's outstanding stock is \$100x. In the Reverse Merger, \$80x of Target stock is exchanged for Corporation X stock, and \$20x of Target stock is exchanged for \$20x of cash.

(b) *Analysis regarding repurchase treatment, timing, and amount.* The exchange by the Target shareholders of their Target stock for the consideration received in the Reverse Merger is a repurchase by Target because that exchange is an economically similar transaction. See section 3.04(4)(a)(i) of this notice. This repurchase occurs on October 1, 2023 (that is, the date on which the Target shareholders exchange their Target shares as part of the Reverse Merger). See section 3.06(1)(b) of this notice. The amount of this repurchase by Target is \$100x, which equals the aggregate fair market value of the Target stock at the time that stock is exchanged by the Target shareholders as part of the Reverse Merger (that is, October 1, 2023). See section 3.06(2)(a) of this notice.

(c) *Analysis regarding impact of Reverse Merger on Target's stock repurchase excise tax base.* Target's stock repurchase excise tax base for its 2023 taxable year is initially increased by \$100x on account of the Reverse Merger. Under the qualifying property exception, the fair market value of the Target stock exchanged by the Target shareholders for Corporation X stock in the Reverse Merger (that is, \$80x of Target stock) is a qualifying property repurchase that reduces Target's stock repurchase excise tax base. See sections 3.03(3)(a) and 3.07(2)(a) of this notice (regarding acquisitive reorganizations). However, the fair market value of the Target stock exchanged by the Target shareholders for the \$20x of cash in the Reverse Merger does not qualify for the qualifying property exception. See sections 3.03(3)(a) and 3.07(2)(a) of this notice. In addition, any Target stock that is deemed to be issued by Target to Merger Sub in exchange for the Merger Consideration is not treated as issued for purposes of computing Target's stock repurchase excise tax base. See section 3.08(4)(h) of this notice. Therefore, Target's stock repurchase excise tax base for its 2023 taxable year is increased by \$20x (\$100x repurchase - \$80x exception = \$20x).

(d) *Analysis regarding Corporation X's stock repurchase excise tax base.* Corporation X's issuance of Corporation X stock in the Reverse Merger is not an issuance for purposes of the netting rule because Corporation X's issuance of that stock is part of a transaction to which the qualifying property exception applies. See generally section 3.08(4)(d) of this notice. Specifically, Corporation X's issuance of Corporation X stock is not an issuance for purposes of the netting rule because (i) the Corporation X stock constitutes property permitted to be received under § 354 without the recognition of gain, (ii) the Corporation X stock is used by a covered corporation (that is, Target) to repurchase its stock in a transaction that is a repurchase under section 3.04(4)(a)(i) of this notice, and (iii) the repurchase by Target is not included in Target's stock repurchase excise tax base because it is a qualifying property repurchase. See section 3.08(4)(d) of this notice. Therefore, Corporation X does not take into account any of the \$80x of its stock issued in the Reverse Merger to reduce its stock repurchase excise tax base for Corporation X's 2023 taxable year. See section 3.08(4)(a) of this notice (disregarding such types of issuances).

(20) *Example 20: Multiple repurchases and contributions of same class of stock—(a) Facts.* On January 15, 2023, Corporation X repurchases 100x shares of its Class A stock that have an aggregate fair market value of \$1,000x. Corporation X repurchases 50x shares of its Class A stock on September 15, 2023, that have an aggregate fair market value of \$200x. Corporation X contributes to its employee stock ownership plan 75x shares of its Class A stock on March 15, 2023, and 75x shares of its Class A stock on October 15, 2023.

(b) *Analysis.* The amount of the reduction to Corporation X's stock repurchase excise tax base is determined by dividing the aggregate fair market value of shares of Class A stock repurchased by the number of shares repurchased (\$1,200x/150x shares = \$8/share) and multiplying the number of shares contributed by the average price of repurchased shares (150x shares x \$8/share = \$1,200x). See sec-

tion 3.07(3)(c)(i) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2023 taxable year is \$0 (\$1,200x repurchase - \$1,200x exception = \$0).

(21) *Example 21: Multiple repurchases and contributions of different class from repurchased shares—(a) Facts.* On January 15, 2023, Corporation X repurchases 100x shares of its Class A stock that have an aggregate fair market value of \$1,000x. Corporation X repurchases 50x shares of its Class A stock on September 15, 2023, that have an aggregate fair market value of \$200x. Corporation X contributes to its employee stock ownership plan 75x shares of its Class B stock on October 15, 2023, that have an aggregate fair market value of \$1,000x. Corporation X contributes to its employee stock ownership plan 25x shares of its Class B stock on December 15, 2023, that have an aggregate fair market value of \$500x.

(b) *Analysis.* The amount of the reduction to Corporation X's stock repurchase excise tax base is equal to the sum of the fair market values of the different class of stock at the time that the stock is contributed to the employer-sponsored retirement plan (\$1,000x + \$500x = \$1,500x). However, the amount of the reduction must not exceed the aggregate fair market value of stock of a different class repurchased during the taxable year by Corporation X (that is, \$1,200x). See section 3.07(3)(c)(ii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2023 taxable year is \$0 (\$1,200x repurchase - \$1,200x exception = \$0).

(22) *Example 22: Restricted stock provided to employee—(a) Facts.* Employee M is an employee of Corporation X. In 2024, as compensation for Employee M's services, Corporation X transfers to Employee M 100x shares of Corporation X restricted stock, when the fair market value of each share is \$50x. The shares vest in 2027. Employee M does not make an election under § 83(b). In 2027, when the shares vest, the shares have a fair market value of \$70x per share. In 2027, Corporation X withholds from Employee M's other wages amounts that are required to pay its income tax and employment tax withholding obligations arising from the stock transfer.

(b) *Analysis.* 100x shares of Corporation X stock are treated as issued or provided to Employee M when they become substantially vested in 2027. See section 3.08(3)(b)(i) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2027 taxable year is reduced by \$7,000x (100x shares x \$70x per share = \$7,000x).

(23) *Example 23: Restricted stock provided to employee with § 83(b) election—(a) Facts.* The facts are the same as in section 3.09(22) of this notice (Example 22), except that Employee M elects under § 83(b) to include the fair market value of the shares of restricted stock in gross income when the shares are transferred.

(b) *Analysis.* 100x shares of Corporation X stock are treated as issued or provided to Employee M when the shares are transferred in 2024. See section 3.08(3)(b)(iii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2024 taxable year is reduced by \$5,000x (100x shares x \$50x per share = \$5,000x). No shares of Corporation X stock are treated as issued or provided to Employee M when the shares vest in 2027.

(24) *Example 24: Vested stock provided to an employee with share withholding—(a) Facts.* Employee N is an employee of Corporation X. In 2024, as compensation for Employee N's services, Corporation X grants Employee N 100x restricted stock units (RSUs). Pursuant to the RSUs, if Employee N remains employed by Corporation X through December 31, 2026, Corporation X will transfer 100x shares of Corporation X stock to Employee N in January 2027. Employee N remains employed by Corporation X through December 31, 2026. In January 2027, when the shares have a fair market value of \$50x per share, Corporation X initiates the transfer of 60x shares of Corporation X stock to Employee N and withholds 40x shares to satisfy its income tax and employment tax withholding obligations.

(b) *Analysis.* 60x shares of Corporation X stock are treated as issued or provided to Employee N when the shares are transferred in 2027. See section 3.08(3)(a)(ii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2027 taxable year is reduced by \$3,000x (60x shares x \$50x per share = \$3,000x).

(25) *Example 25: Stock option net exercise—(a) Facts.* Employee O is an employee of Corporation X. In 2024, Corporation X transfers to Employee O options to purchase 100x shares of Corporation X stock with an exercise price of \$40x per share. The options are described in § 1.83-7 and do not have a readily ascertainable fair market value. Employee O exercises the option to purchase 100x shares in 2025 when the fair market value is \$50x per share. Corporation X withholds 80x shares to pay the exercise price.

(b) *Analysis.* 20x shares of Corporation X stock are treated as issued or provided to Employee O when the options are exercised in 2025. See section 3.08(3)(a)(iii) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2025 taxable year is reduced by \$1,000x (20x shares x \$50x per share = \$1,000x).

(26) *Example 26: Broker-assisted net exercise—(a) Facts.* The facts are the same as section 3.09(25) of this notice (Example 25), except that instead of Corporation X withholding shares to pay the exercise price, a third-party broker pays an amount equal to the exercise price to Corporation X. Corporation X transfers 100x shares of Corporation X stock to the third-party broker, who then deposits the 100x shares into Employee O's account. The third-party broker then immediately sells 80x shares to recover the exercise price paid to Corporation X.

(b) *Analysis.* 100x shares of Corporation X stock are treated as issued or provided to Employee O when the shares are transferred to the broker in 2025. See section 3.08(3)(a)(iv) of this notice. Therefore, Corporation X's stock repurchase excise tax base for its 2025 taxable year is reduced by \$5,000x (100x shares x \$50x per share = \$5,000x).

SECTION 4. REPORTING AND PAYMENT OF STOCK REPURCHASE EXCISE TAX

The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will provide that the stock repurchase excise tax must be reported on

IRS Form 720, *Quarterly Federal Excise Tax Return*. To facilitate the computation of the stock repurchase excise tax, the IRS also intends to issue an additional form that taxpayers will be required to attach to the Form 720.

Although the Form 720 is filed quarterly, the Treasury Department and the IRS expect the forthcoming proposed regulations to provide that the stock repurchase excise tax will be reported once per taxable year on the Form 720 that is due for the first full quarter after the close of the taxpayer's taxable year. For example, a taxpayer with a taxable year ending on December 31, 2023, would report its stock repurchase excise tax on the Form 720 for the first quarter of 2024, due on April 30, 2024. The Treasury Department and the IRS expect the forthcoming proposed regulations to provide that the deadline for payment of the stock repurchase excise tax is the same as the filing deadline, and that no extensions are permitted for reporting or paying the stock repurchase excise tax owed.

SECTION 5. APPLICABILITY DATES

.01 *In general*. It is anticipated that the forthcoming proposed regulations will provide that rules consistent with the rules described in section 3 of this notice generally apply to repurchases of stock of a covered corporation made after December 31, 2022, and to issuances of stock made during a taxable year ending after December 31, 2022.

.02 *Funded Purchases*. It is anticipated that the forthcoming proposed regulations will provide that rules consistent with the rules described in section 3.05(2)(a)(ii) of this notice apply to repurchases and acquisitions of stock made after December 31, 2022, that are funded on or after December 27, 2022.

.03 *Reliance*. Until the date of issuance of the forthcoming proposed regulations, a taxpayer may rely on the rules set forth in section 3 of this notice.

SECTION 6. REQUEST FOR COMMENTS

.01 *Comments regarding rules included in notice*. The Treasury Department

and the IRS request comments on the rules described in this notice. In particular, the Treasury Department and the IRS request comments that address the following specific questions:

(1) Are there circumstances under which special rules should be provided for redeemable preferred stock or other special classes of stock or debt (including debt with features that allow the debt, whether by the issuer, the holder, or otherwise, to be converted into stock)? If so, please provide objectively verifiable criteria that such special rules should incorporate to provide certainty for taxpayers and the IRS.

(2) Should the fair market value of stock repurchased be an amount other than the market price of such stock in determining the amount of a covered corporation's repurchases?

(3) For purposes of the netting rule, should the fair market value of stock issued or provided be an amount other than the market price of such stock in determining the amount of a covered corporation's issuances?

(4) Should the definition of an employer-sponsored retirement plan include plans other than plans that are qualified under § 401(a)?

(5) With regard to contributions of repurchased stock by a covered corporation to an employer-sponsored retirement plan, what additional provisions (if any) would be helpful to address fact patterns in which multiple classes of stock are both repurchased and contributed by that covered corporation?

(6) Should a method be provided for determining the market price of stock that is traded on multiple established securities markets? If so, what modifications to the rules in sections 3.06(2)(a)(i) and 3.08(5)(a)(i) of this notice would be required?

(7) Should there be additional methods to rebut the presumption in section 3.07(6)(b)(i) of this notice? If so, what modifications to section 3.07(6)(b) of this notice would be required?

.02 *Comments regarding rules not included in notice*. The Treasury Department and the IRS request comments on other questions arising under § 4501 that should be addressed in guidance. Commenters are encouraged to specify the issues on which guidance is needed most

quickly as well as the most important issues on which guidance is needed. In addition to general comments regarding § 4501, the Treasury Department and the IRS request comments that address the following questions that are anticipated to be addressed in the forthcoming proposed regulations:

(1) What factors should the Treasury Department and the IRS consider in developing guidance regarding indirect ownership for purposes of determining whether a corporation or a partnership is a specified affiliate?

(2) When should a corporation be treated as becoming or ceasing to be a covered corporation, and how should repurchases and issuances by a corporation during a taxable year that are prior to the date the corporation becomes a covered corporation or after the date the corporation ceases to be a covered corporation be treated?

(3) Should special rules be provided for bankrupt or troubled companies? For example, should a § 317(b) redemption occurring as part of a restructuring of a bankrupt or troubled company be excluded from the definition of "repurchase"?

(4) Should any additional rules with regard to financial arrangements, such as options or other similar financial instruments, be added to prevent avoidance of the stock repurchase excise tax? If so, please describe how such additional rules should apply consistently for purposes of determining a covered corporation's repurchases and issuances.

(5) How should the stock repurchase excise tax be allocated among expatriated entities if there are multiple expatriated entities treated as a covered corporation with respect to a covered surrogate foreign corporation? Are other special rules necessary or appropriate in such a case?

(6) If the applicable specified affiliate is a foreign partnership that has a domestic entity as a direct or indirect partner and is treated as a covered corporation:

(a) Should the foreign partnership or its domestic entity partner, or both, be required to file Form 720?

(b) Should the foreign partnership or its domestic entity partner be required to pay the stock repurchase excise tax? If the foreign partnership is required to pay the tax, should special rules or procedures apply to collect the tax?

(c) Should other special rules or procedures apply in this case, including if there are multiple domestic entities that are direct or indirect partners?

(7) What factors should the Treasury Department and the IRS consider in determining whether a domestic entity is an indirect partner in a foreign partnership?

(8) For purposes of the special netting rules in § 4501(d):

(a) Should stock issued or provided to any employees of the foreign partnership be taken into account, or should the netting rule be limited to stock issued or provided only to employees of the domestic entity that is a direct or indirect partner, in cases of a foreign partnership that is the applicable specified affiliate?

(b) Are there any circumstances in which stock of the applicable specified affiliate or expatriated entity, as relevant, should be taken into account in addition to, or in lieu of, stock of the applicable foreign corporation or covered surrogate foreign corporation, respectively?

(9) Should the definition of “established securities market” be revised to clarify which regulatory requirements under the Securities Exchange Act of 1934 are most relevant to the determination of whether a foreign securities market is treated as an established securities market? If so, what type of U.S. securities exchange (including which tier of an exchange with multiple tiers) should be the baseline for comparison?

(10) How should the trading of stock through depository receipts be treated for purposes of determining whether a corporation is a covered corporation, or whether repurchased stock is traded on an established securities market?

.03 Procedures for submitting comments.

(1) *Deadline.* Written comments should be submitted by March 20, 2023. Consideration will also be given to any written comment submitted after March 20, 2023, though such comments may not be considered in the development of the forthcoming proposed regulations if such consideration would delay the issuance of the forthcoming proposed regulations

(2) *Form and manner.* The subject line for the comments should include a reference to Notice 2023-2. All commenters

are strongly encouraged to submit comments electronically. Comments may be submitted in one of two ways:

(a) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2023-0002 in the search field on the www.regulations.gov homepage to find this notice and submit comments); or

(b) By mail to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2023-2), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

(3) *Publication of comments.* The Treasury Department and the IRS will publish for public availability any comment submitted electronically and on paper to its public docket on www.regulations.gov.

SECTION 7. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Samuel G. Trammell of the Office of the Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in its development. For further information on rules concerning stock issued or provided to employees under § 4501(c) (3), please contact William L. McNally of the Office the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) at (202) 317-5600 (not a toll-free number). For further information on rules concerning § 4501(d), please contact Arielle M. Borsos of the Office the Associate Chief Counsel (International) at (202) 317-6937 (not a toll-free number). For further information on rules concerning § 4501(e)(2), please contact Naomi Lehr of the Office the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) at (202) 317-4102 (not a toll-free number). For further information on rules concerning § 4501(e)(4) and (5), please contact Jonathan A. LaPlante of the Office the Associate Chief Counsel (Financial Institutions & Products) at (202) 317-5102 (not a toll-free number). For further information on all other rules, please contact Mr. Trammell at (202) 317-5024 (not a toll-free number).

2023 Standard Mileage Rates

Notice 2023-3

SECTION 1. PURPOSE

This notice provides the optional 2023 standard mileage rates for taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This notice also provides the amount taxpayers must use in calculating reductions to basis for depreciation taken under the business standard mileage rate, and the maximum standard automobile cost that may be used in computing the allowance under a fixed and variable rate (FAVR) plan. Additionally, this notice provides the maximum fair market value (FMV) of employer-provided automobiles first made available to employees for personal use in calendar year 2023 for which employers may use the fleet-average valuation rule in § 1.61-21(d)(5)(v) or the vehicle cents-per-mile valuation rule in § 1.61-21(e).¹

SECTION 2. BACKGROUND

Rev. Proc. 2019-46, 2019-49 I.R.B. 1301, provides rules for computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes, and for substantiating, under § 274(d) and § 1.274-5, the amount of ordinary and necessary business expenses of local transportation or travel away from home. Taxpayers using the standard mileage rates must comply with Rev. Proc. 2019-46. However, a taxpayer is not required to use the substantiation methods described in Rev. Proc. 2019-46, but instead may substantiate using actual allowable expense amounts if the taxpayer maintains adequate records or other sufficient evidence.

An independent contractor conducts an annual study for the Internal Revenue Service of the fixed and variable costs of operating an automobile to determine the standard mileage rates for business, med-

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Internal Revenue Code (Code) or the Income Tax Regulations (26 CFR part 1).

ical, and moving use reflected in this notice. The standard mileage rate for charitable use is set by § 170(i).

Longstanding regulations under § 61 provide special valuation rules for employer-provided automobiles. The amount that must be included in the employee's income and wages for the personal use of an employer-provided automobile generally is determined by reference to the automobile's FMV. If an employer chooses to use a special valuation rule, the special value is treated as the FMV of the benefit for income tax and employment tax purposes. Section 1.61-21(b)(4). Two such special valuation rules, the fleet-average valuation rule and the vehicle cents-per-mile valuation rule, are set forth in § 1.61-21(d)(5)(v) and § 1.61-21(e), respectively. These two special valuation rules are subject to limitations, including that they may be used only in connection with automobiles having values that do not exceed a maximum amount set forth in the regulations.

SECTION 3. STANDARD MILEAGE RATES

The standard mileage rate for transportation or travel expenses is 65.5 cents per mile for all miles of business use (business standard mileage rate). See section 4 of Rev. Proc. 2019-46. However, § 11045 of Public Law 115-97, 131. Stat. 2054 (December 22, 2017), commonly known as the Tax Cuts and Jobs Act (TCJA) suspends all miscellaneous itemized deductions that are subject to the two-percent of adjusted gross income floor under § 67, including unreimbursed employee travel expenses, for taxable years beginning after December 31, 2017, and before January 1, 2026. Thus, the business standard mileage rate provided in this notice cannot be used to claim an itemized deduction for unreimbursed employee travel expenses during the suspension. Notwithstanding the foregoing suspension of miscellaneous itemized deductions, deductions for expenses that are deductible in determining adjusted gross income are not suspended. For example, members of a reserve component of the Armed Forces of the United States (Armed Forces), state or local

government officials paid on a fee basis, and certain performing artists are entitled to deduct unreimbursed employee travel expenses as an adjustment to total income on line 12 of Schedule 1 of Form 1040 (2022), *U.S. Individual Income Tax Return*, not as an itemized deduction on Schedule A of Form 1040 (2022), and therefore may continue to use the business standard mileage rate.

The standard mileage rate is 14 cents per mile for use of an automobile in rendering gratuitous services to a charitable organization under § 170. See section 5 of Rev. Proc. 2019-46.

The standard mileage rate is 22 cents per mile for use of an automobile: (1) for medical care described in § 213; or (2) as part of a move for which the expenses are deductible under § 217(g). See section 5 of Rev. Proc. 2019-46. Section 11049 of the TCJA suspends the deduction for moving expenses for taxable years beginning after December 31, 2017, and before January 1, 2026. However, the suspension does not apply to members of the Armed Forces on active duty who move pursuant to a military order and incident to a permanent change of station. Thus, except for taxpayers to whom § 217(g) applies, the standard mileage rate provided in this notice is not applicable for the use of an automobile as part of a move occurring during the suspension.

SECTION 4. BASIS REDUCTION AMOUNT

For automobiles a taxpayer uses for business purposes, the portion of the business standard mileage rate treated as depreciation is 26 cents per mile for 2019, 27 cents per mile for 2020, 26 cents per mile for 2021, 26 cents per mile for 2022, and 28 cents per mile for 2023. See section 4.04 of Rev. Proc. 2019-46.

SECTION 5. MAXIMUM STANDARD AUTOMOBILE COST

For purposes of computing the allowance under a FAVR plan, the standard automobile cost may not exceed \$60,800 for automobiles (including trucks and vans). See section 6.02(6) of Rev. Proc. 2019-46.

SECTION 6. MAXIMUM VALUE OF EMPLOYER-PROVIDED AUTOMOBILES

For purposes of the fleet-average valuation rule in § 1.61-21(d)(5)(v) and the vehicle cents-per-mile valuation rule in § 1.61-21(e), the maximum FMV of automobiles (including trucks and vans) first made available to employees in calendar year 2023 is \$60,800.

SECTION 7. EFFECTIVE DATE

This notice is effective for: (1) deductible transportation expenses paid or incurred on or after January 1, 2023; (2) mileage allowances or reimbursements paid to a charitable volunteer or a member of the Armed Forces to whom § 217(g) applies: (a) on or after January 1, 2023, and (b) for transportation expenses the charitable volunteer or such member of the Armed Forces pays or incurs on or after January 1, 2023; and (3) for purposes of the maximum FMV of employer-provided automobiles for which employers may use the fleet-average valuation rule in § 1.61-21(d)(5)(v) or the vehicle cents-per-mile rule in § 1.61-21(e), automobiles first made available to employees for personal use on or after January 1, 2023.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Notice 2022-03 is superseded.

DRAFTING INFORMATION

The principal author of this notice is Christian Lagorio of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information on this notice regarding the use of an employer-provided automobile, contact Mr. Lagorio at (202) 317-7005 (not a toll-free number). For further information on this notice regarding the use of an employer-provided automobile, contact Stephanie Caden of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes), at (202) 317-4774 (not a toll-free number).

Initial Guidance Regarding the Application of the Corporate Alternative Minimum Tax under Sections 55, 56A, and 59 of the Internal Revenue Code

Notice 2023-7

SECTION 1. OVERVIEW

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue proposed regulations (forthcoming proposed regulations) addressing the application of the new corporate alternative minimum tax (CAMT), as added to the Internal Revenue Code (Code)¹ by the enactment of § 10101 of Public Law 117-169, 136 Stat. 1818, 1818-1828 (August 16, 2022), commonly referred to as the Inflation Reduction Act of 2022 (IRA). Sections 3 through 7 of this notice provide interim guidance regarding certain time-sensitive issues intended to be addressed by the forthcoming proposed regulations. Taxpayers may rely on the guidance provided in sections 3 through 7 of this notice until the issuance of the forthcoming proposed regulations.

In addition, the Treasury Department and the IRS intend to issue additional interim guidance to address other CAMT issues prior to the issuance of the forthcoming proposed regulations. Such additional interim guidance is expected to address, among other issues, certain issues related to the treatment under the CAMT of items that are marked-to-market for financial statement purposes (such as life insurance company separate account assets and certain financial products), the treatment of certain items reported in other comprehensive income (OCI), and the treatment of embedded derivatives arising from certain reinsurance contracts. This additional interim guidance would be intended to help avoid substantial unintended adverse consequences to the insurance industry and certain other industries. See

section 9.02 of this notice, which requests comments on these as well as other issues under the CAMT not addressed by this notice but that will be addressed in forthcoming proposed regulations.

Section 2 of this notice provides a summary of relevant law underlying the rules described in sections 3 through 7 of this notice. Section 3 of this notice describes rules that address certain issues under the CAMT regarding (i) subchapter C of chapter 1 of the Code (subchapter C) and subchapter K of chapter 1 of the Code (subchapter K), (ii) troubled corporations, and (iii) affiliated groups of corporations that join in filing (or that are required to join in filing) a consolidated return for Federal income tax purposes (tax consolidated groups). Section 4 of this notice describes rules that address certain CAMT issues with respect to the depreciation of property to which § 168 applies. Section 5 of this notice describes a safe harbor method for determining whether a corporation is an “applicable corporation” subject to the CAMT. Section 6 of this notice describes rules that address issues regarding the treatment of certain Federal income tax credits under the CAMT. Section 7 of this notice describes rules that address the determination of applicable corporation status in circumstances involving certain partnerships.

Section 8 of this notice describes the anticipated applicability dates of the forthcoming proposed regulations. Section 9 of this notice requests comments on the issues addressed in this notice as well as specific issues not so addressed. Section 10 of this notice provides drafting and contact information.

SECTION 2. BACKGROUND

.01 CAMT Under the Inflation Reduction Act

(1) *Overview.* Section 10101 of the IRA amended § 55 to impose the new CAMT based on the “adjusted financial statement income” (AFSI) of an applicable corporation for taxable years beginning after December 31, 2022. In general, a corporation is an applicable corporation subject to the CAMT for a taxable year if it meets an average annual AFSI test for one or more

taxable years that (i) are before that taxable year and (ii) end after December 31, 2021. See section 2.01(4) of this notice.

(2) *Imposition of CAMT.* Section 55(a) provides that, for the taxable year of an applicable corporation, the amount of CAMT imposed by § 55 equals the excess (if any) of (i) the tentative minimum tax for the taxable year, over (ii) the sum of the regular income tax imposed for the taxable year plus the tax imposed under § 59A (commonly referred to as the base erosion and anti-abuse tax, or BEAT). Section 55(b)(2)(A) provides that, in the case of an applicable corporation, the *tentative minimum tax* for the taxable year is the excess of (i) 15 percent of AFSI for the taxable year (as determined under § 56A), over (ii) the CAMT foreign tax credit for the taxable year. See § 59(l). In the case of any corporation that is not an applicable corporation, § 55(b)(2)(B) provides that the tentative minimum tax for the taxable year is zero.

(3) AFSI under § 56A.

(a) *General definition of AFSI.* For purposes of §§ 55 through 59, the term *AFSI* means, with respect to any corporation for any taxable year, the net income or loss of the taxpayer set forth on the taxpayer’s applicable financial statement (AFS) for that taxable year, adjusted as provided in § 56A. See § 56A(a).

(b) *General definition of AFS.* For purposes of § 56A, the term *AFS* means, with respect to any taxable year, an AFS, as defined in § 451(b)(3) or as specified by the Secretary of the Treasury or her delegate (Secretary) in regulations or other guidance, that covers that taxable year. See § 56A(b).

(c) General adjustments to AFSI.

(i) *Special rule regarding consolidated financial statements.* Section 56A(c)(2)(A) provides that, if the financial results of a taxpayer are reported on the AFS for a group of entities (AFS Group), rules similar to the rules of § 451(b)(5) apply. Section 451(b)(5) provides that in such a situation the AFS of the AFS Group is the AFS of the taxpayer. Section 1.451-3(h)(1) through (3) provide rules under § 451(b)(5), including rules for determining the extent to which amounts reflected on the AFS of the AFS Group and the un-

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

derlying source documents are allocable to the taxpayer for purposes of applying the rules under § 451(b). For purposes of this notice, the term AFS Group also includes a single entity with an AFS that does not consolidate the financial results of such entity with the financial results of any other entity.

(ii) *Special rule regarding consolidated returns.* Section 56A(c)(2)(B) provides a general rule that, if the taxpayer is part of a tax consolidated group for any taxable year, AFSI for that group for that taxable year must take into account items on the group's AFS that are properly allocable to members of that group. However, § 56A(c)(2)(B) provides the Secretary with authority to prescribe by regulation exceptions to that general rule.

(iii) *AFSI of partners and partnerships.* Section 56A(c)(2)(D)(i) provides that, except as provided by the Secretary, if the taxpayer is a partner in a partnership, the taxpayer's AFSI with respect to such partnership is adjusted to take into account only the taxpayer's distributive share of such partnership's AFSI. Section 56A(c)(2)(D)(ii) provides that, for purposes of §§ 55 through 59, the AFSI of a partnership is the partnership's net income or loss set forth on that partnership's AFS (adjusted under rules similar to the rules set forth in § 56A).

(iv) *Adjustments with respect to certain Federal income tax credits.* Section 56A(c)(9) requires AFSI to be appropriately adjusted to disregard any amount treated as a payment against the tax imposed by subtitle A of the Code pursuant to an election under §§ 48D(d) or 6417 and included in the net income or loss set forth on the taxpayer's AFS. However, if such amount is otherwise disregarded under the adjustment rule in § 56A(c)(5) (regarding AFSI adjustments for certain taxes), the adjustment in § 56A(c)(9) does not apply. See § 56A(c)(9).

(v) *Adjustments with regard to Federal income tax depreciation.* Section 56A(c)(13)(A) requires AFSI to be reduced by depreciation deductions allowed under § 167 with respect to property to which § 168 applies, to the extent of the amount allowed as deductions in computing taxable income for the taxable year. In addition, § 56A(c)(13)(B)(i) requires appropriate adjustments to AFSI to disregard

any amount of depreciation expense that is taken into account on the taxpayer's AFS with respect to property to which § 168 applies. Lastly, § 56A(c)(13)(B)(ii) provides that AFSI is appropriately adjusted to take into account any other item specified by the Secretary in order to provide that the property to which § 168 applies is accounted for in the same manner as that property is accounted for under chapter 1 of the Code.

(d) *Authority of the Secretary to provide necessary adjustments.* Section 56A(c)(15) authorizes the Secretary to issue regulations or other guidance to provide for such adjustments to AFSI as the Secretary determines necessary to carry out the purposes of § 56A, including adjustments to AFSI (i) to prevent the omission or duplication of any item, and (ii) to carry out the principles of part II of subchapter C (relating to corporate liquidations), part III of subchapter C (relating to corporate organizations and reorganizations), and part II of subchapter K (relating to partnership contributions and distributions).

(e) *General authority of the Secretary.* Section 56A(e) authorizes the Secretary to provide such regulations and other guidance as necessary to carry out the purposes of § 56A, including regulations and other guidance relating to the effect of the rules of § 56A on partnerships with income taken into account by an applicable corporation.

(4) *Qualification as an applicable corporation under § 59(k).*

(a) *Overview.* Section 59(k)(1)(A) provides that, for purposes of §§ 55 through 59, the term *applicable corporation* means, with respect to any taxable year, any corporation (other than an S corporation (as defined in § 1361(a)(1)), a regulated investment company (as defined in § 851), or a real estate investment trust (as defined in § 856)) that meets one of the average annual AFSI tests under § 59(k)(1)(B) (each, an AFSI test) for one or more taxable years that (i) are prior to that taxable year and (ii) end after December 31, 2021.

(b) *AFSI tests.*

(i) *Overview.* Section 59(k)(1)(B) provides two sets of rules for determining whether a corporation meets an AFSI test. First, under § 59(k)(1)(B)(i), a corporation meets the AFSI test for a taxable

year if the average annual AFSI of that corporation (determined without regard to the adjustment under § 56A(d) for financial statement net operating losses) for the three-taxable-year period ending with that taxable year (Three-Taxable-Year Period) exceeds \$1,000,000,000 (general AFSI test). Second, in the case of a corporation that is a member of a foreign-parented multinational group (as defined in § 59(k)(2)(B)) for any taxable year, that corporation meets the AFSI test for that taxable year under § 59(k)(1)(B)(ii) if (i) that corporation meets the general AFSI test (determined after applying the special foreign-parented multinational group rule in § 59(k)(2)), and (ii) the average annual AFSI of that corporation (determined without regard to the special foreign-parented multinational group rule in § 59(k)(2) and without regard to the adjustment described in § 56A(d) for financial statement net operating losses) for the Three-Taxable-Year Period is at least \$100,000,000 (foreign-parented multinational group AFSI test).

(ii) *Special aggregation rules and AFSI rules for determining applicable corporation status.* Solely for purposes of determining whether a corporation is an applicable corporation under § 59(k)(1), § 59(k)(1)(D) requires that all AFSI of persons treated as a single employer with that corporation under § 52(a) or (b) is treated as AFSI of that corporation. Section 59(k)(1)(D) also provides that, solely for purposes of determining whether a corporation is an applicable corporation, the AFSI of such corporation must be determined without regard to the distributive share adjustment under § 56A(c)(2)(D)(i) (see section 2.01(3)(c)(iii) of this notice) and the adjustments under § 56A(c)(11) pertaining to covered benefit plans (as defined in § 56A(c)(11)(B)). In addition, § 59(k)(2)(A) provides a special foreign-parented multinational group rule pursuant to which, solely for purposes of determining whether a corporation that is a member of a foreign-parented multinational group meets the general AFSI test, (i) the AFSI of such corporation must include the AFSI of all members of such group, and (ii) AFSI is determined without regard to the partnership distributive share adjustment under § 56A(c)(2)(D)(i) (see section 2.01(3)(c)(iii) of this notice), the

foreign income pro rata share adjustment under § 56A(c)(3), the effectively connected income adjustment under § 56A(c)(4), and the adjustments under § 56A(c)(11) pertaining to covered benefit plans (as defined in § 56A(c)(11)(B)).

(c) *Special rules regarding AFSI and the AFSI tests.* Section 59(k)(1)(E) provides additional special rules for purposes of determining whether a corporation is an applicable corporation.

(i) *AFSI calculation for short taxable years.* With regard to a corporation with AFSI for any taxable year of less than 12 months, the AFSI of that corporation (including any predecessor) is annualized by multiplying the AFSI for the short period by 12 and dividing the result by the number of months composing the short period. *See* §§ 59(k)(1)(E)(ii) and (iii).

(ii) *AFSI tests for corporations in existence for less than three taxable years.* If a corporation has been in existence for less than three taxable years, the AFSI tests are applied to that corporation on the basis of the period during which that corporation was in existence. *See* § 59(k)(1)(E)(i). Section 59(k)(1)(E)(iii) provides that a reference in § 59(k)(1)(E) to a corporation includes a reference to any predecessor of such corporation. Accordingly, for purposes of this section 2.01(4)(c)(ii), whether a corporation was in existence for less than three taxable years and, if so, the period on the basis of which the AFSI tests are applied to that corporation include the period(s) of existence of any predecessor(s) of such corporation. *See* § 59(k)(1)(E)(i) and (iii).

(d) *Corporations excluded from applicable corporation status.* Section 59(k)(1)(C) excludes corporations from the definition of applicable corporation if the following requirements are satisfied. First, the corporation must have either (i) a change in ownership, or (ii) a specified number of consecutive taxable years (as determined by the Secretary, taking into account the taxpayer's facts and circumstances), including the most recent taxable year, in which the corporation does not meet an AFSI test. *See* § 59(k)(1)(C)(i). Second, the Secretary must determine that it would not be appropriate to continue to treat that corporation as an applicable corporation (appropriateness determination). *See* § 59(k)(1)(C)(ii). However, as

provided in the last sentence of § 59(k)(1)(C), a corporation that satisfies these two requirements for exclusion from applicable corporation status nonetheless will be treated as an applicable corporation if that corporation subsequently meets an AFSI test for any taxable year beginning after the first taxable year for which an appropriateness determination applies.

(e) *Regulations and other guidance to carry out statutory applicable corporation rules.* Section 59(k)(3) authorizes the Secretary to provide regulations or other guidance for the purposes of carrying out § 59(k), including regulations or other guidance (i) to provide a simplified method for determining whether a corporation meets the requirements to qualify as an applicable corporation, and (ii) to address the application of § 59(k) to a corporation that experiences a change in ownership.

.02 Cancellation of Indebtedness (COD) Income.

(1) *Overview.* Section 61(a)(11) provides that, except as otherwise provided in subtitle A of the Code, gross income includes income from the discharge of indebtedness. Section 108(a)(1) provides that gross income does not include any amount that otherwise would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer, if the discharge occurs under circumstances specified in § 108(a)(1)(A) through (E), including: (i) in a title 11 case, (ii) when the taxpayer is insolvent, or (iii) with respect to qualified farm indebtedness (excluded COD income). *See* § 108(a)(1)(A), (B), and (C), respectively. In the case of a discharge to which the insolvency exclusion of § 108(a)(1)(B) applies, the amount of excluded COD income is limited under § 108(a)(3) to the amount by which the taxpayer is insolvent.

(2) Reduction of tax attributes.

(a) *In general.* Section 108(b)(1) provides that the amount of excluded COD income is applied to reduce the tax attributes of the taxpayer as provided in § 108(b)(2), subject to the special rules of § 108(g) for discharges of qualified farm indebtedness.

(b) *Order in which attributes are reduced.* Section 108(b)(2) provides that, except as provided in § 108(b)(5), the following tax attributes are reduced in

the following order: (i) any net operating loss (NOL) for the taxable year of the discharge, and any NOL carryover to that taxable year; (ii) any amounts carried to or from the taxable year of the discharge for purposes of determining the amount allowable as a general business credit under § 38; (iii) the amount of the minimum tax credit available under § 53(b) as of the beginning of the taxable year immediately following the taxable year of the discharge; (iv) any net capital loss for the taxable year of the discharge, and any capital loss carryover to that taxable year under § 1212; (v) the basis of the property of the taxpayer (*see* § 1017 for provisions for making this reduction); (vi) any passive activity loss or credit carryover of the taxpayer under § 469(b) from the taxable year of the discharge; and (vii) any carryover to or from the taxable year of the discharge for purposes of determining the amount of the foreign tax credit allowable under § 27.

(c) *Election to reduce basis before other attributes.* In lieu of applying the rules of § 108(b)(2) to reduce a taxpayer's attributes by the amount referred to in § 108(b)(1), a taxpayer may elect under § 108(b)(5) to reduce under § 1017 the basis of the taxpayer's depreciable property by that amount, to the extent of the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs. Section 108(b)(2) does not apply to any amount to which an election under § 108(b)(5) applies.

(3) *Exclusion of remaining amounts.* Any amount of debt discharge that remains after attribute reduction is not includible in income. *See* H.R. Rep. 96-833 at 11 (1980); S. Rep. No. 96-1035 at 12 (1980). This type of excluded COD income is commonly referred to as "black hole excluded COD income."

.03 *Consolidated Return Regulations.* Section 1502 authorizes the Secretary to prescribe regulations to clearly reflect the Federal income tax liability of a tax consolidated group, and to prevent avoidance of such tax liability. *See* § 1.1502-1(h) (defining the term *consolidated group* for Federal income tax purposes). For purposes of carrying out those objectives, § 1502 also permits the Secretary to prescribe

rules that may be different from the provisions of chapter 1 of the Code that would apply if the corporations composing the tax consolidated group filed separate returns.

.04 Treatment of Certain Credits in Computing Taxable Income.

(1) *Elective payments under § 6417.* Section 6417(a) applies to an applicable entity (as defined in § 6417(d)(1)) that makes an election under § 6417 with regard to any applicable credit (as defined in § 6417(b)) determined with regard to that applicable entity. If § 6417(a) applies, that entity is treated as making a payment against the tax imposed by subtitle A of the Code (for the taxable year with respect to which that applicable credit was determined) equal to the amount of that applicable credit. See § 6417(a). Section 6417(c) provides, in part, that, in the case of any facility or property held directly by a partnership, any election under § 6417(a) must be made by such partnership. If such partnership makes the election under § 6417(a), the Secretary is authorized to make a payment to such partnership equal to the amount of such credit, and the payment is treated as tax-exempt income for purposes of § 705. See § 6417(c)(1). The Treasury Department and the IRS intend to provide guidance regarding how and when an election under § 6417 may be made.

(2) *Elective transfers under § 6418.* Section 6418(a) applies to an eligible taxpayer (as defined in § 6418(f)(2)) that elects to transfer all (or any portion specified in the election) of an eligible credit (as defined in § 6418(f)(1)) determined with regard to that taxpayer for any taxable year to another taxpayer (transferee taxpayer) that is not related (within the meaning of §§ 267(b) or 707(b)(1)) to the eligible taxpayer. The transferee taxpayer specified in that election is treated as the taxpayer for purposes of the Code with regard to that credit (or such portion thereof). See § 6418(a). Pursuant to § 6418(b)(2), any amount received from the transfer of an eligible credit is excluded from gross income of the eligible taxpayer. Section 6418(c)(1) provides, in part, that, in the case of any eligible credit determined with respect to any facility or property held directly by a partnership, if such partnership makes an election under

§ 6418(a) with respect to such credit, any amount received from the transfer of the credit is treated as tax-exempt income for purposes of § 705. The Treasury Department and the IRS intend to provide guidance regarding how and when an election under § 6418 may be made.

(3) *Advanced Manufacturing Investment Credit under § 48D.* Section 48D(a) provides that, for purposes of § 46 (which provides rules for determining the amount of the investment tax credit for purposes of the general business tax credit under § 38), the advanced manufacturing investment credit under § 48D (§ 48D credit) for any taxable year is an amount equal to 25 percent of the qualified investment (as defined in § 48D(b)) for such taxable year with respect to any advanced manufacturing facility (as defined in § 48D(b)(3)) of an eligible taxpayer (as defined in § 48D(c)). Section 48D(d)(1) provides that, in the case of a taxpayer (other than a partnership or S corporation) making an election with respect to the § 48D credit determined with respect to such taxpayer, such taxpayer is treated as making a payment against the tax imposed by subtitle A (for the taxable year with respect to which such credit was determined) equal to the amount of such credit. Section 48D(d)(2)(A)(i) provides, in part, that, in the case of the § 48D credit determined with respect to any property held directly by a partnership, any election under § 48D(d)(1) must be made by such partnership. If such partnership makes the election under § 48D(d)(1), the Secretary is authorized to make a payment to such partnership equal to the amount of such credit, and the payment is treated as tax-exempt income for purposes of § 705. See § 48D(d)(2)(A)(i). The Treasury Department and the IRS intend to provide guidance regarding how and when an election under § 48D(d) may be made.

SECTION 3. AFSI AND APPLICABLE CORPORATION STATUS RESULTING FROM CERTAIN TRANSACTIONS; TAX CONSOLIDATED GROUPS

.01 Purpose. The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will be consistent with the guidance provided in this

section 3. The Treasury Department and the IRS are providing this interim guidance to facilitate the ability for taxpayers to apply the CAMT to certain corporate transactions and other situations occurring prior to the issuance of the forthcoming proposed regulations.

.02 Defined Terms. For purposes of this section 3:

(1) *Accounting Standards Codification.* The term *Accounting Standards Codification* means the single source of authoritative nongovernmental U.S. generally accepted accounting principles (that is, U.S. GAAP).

(2) *Common Parent Corporation.* The term *Common Parent Corporation* means the parent corporation of a group of entities whose activities are consolidated for financial accounting purposes.

(3) *Acquirer AFS Group.* The term *Acquirer AFS Group* means a corporation or one or more chains of entities connected through ownership with a Common Parent Corporation that—

(a) composes or compose an AFS Group,

(b) is or are a Party to a Covered Transaction, and

(c) is or are treated on its AFS as acquiring a Target or Target AFS Group (or the assets thereof).

(4) *Controlled.* The term *Controlled* means one corporation, or one or more chains of entities connected through ownership with a Common Parent Corporation, that—

(a) composes or compose a portion of a Distributing AFS Group (as defined in section 3.02(8) of this notice),

(b) is or are a Party to a Covered Transaction, and

(c) is or are treated as the corporation the stock of which is distributed by a Distributing AFS Group on the AFS of the Distributing AFS Group (for example, a *spinnee* under the Accounting Standards Codification).

(5) *Covered Nonrecognition Transaction.*

(a) *In general.* The term *Covered Nonrecognition Transaction* means a transaction that, solely with regard to a corporation or a partnership (as appropriate), qualifies for nonrecognition treatment for Federal income tax purposes, under §§ 332, 337, 351, 354, 355, 357, 361, 368,

721, 731, or 1032, or a combination thereof, and is not treated as resulting in any amount of gain or loss for Federal income tax purposes (that is, solely with regard to the corporation or partnership, as appropriate).

(b) *Qualification of each component transaction determined separately.* For purposes of section 3.02(5)(a) of this notice, each component transaction of a larger transaction is examined separately for qualification as a *Covered Nonrecognition Transaction* (for example, nonrecognition treatment of a liability assumption component under § 357 and a transfer component under § 361(c)(3) are evaluated separately for determining qualification of each component as a *Covered Nonrecognition Transaction*, notwithstanding that each component could be a component transaction of a larger transaction that includes Covered Nonrecognition Transactions under §§ 368(a)(1)(D) and 355). Because Covered Nonrecognition Transaction status requires nonrecognition treatment for Federal income tax purposes, the treatment of a component transaction as a Covered Nonrecognition Transaction may be affected by the Federal income tax consequences of any other component transaction of the larger transaction as well as all other component transactions of the larger transaction (for example, taking into account all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine).

(6) *Covered Recognition Transaction.*

(a) *In general.* The term *Covered Recognition Transaction* means a transfer, sale, contribution, distribution, or other disposition of property treated as resulting in gain or loss for Federal income tax purposes (that is, a transfer, sale, contribution, distribution, or other disposition of property that does not qualify as a Covered Nonrecognition Transaction).

(b) *Qualification of each component transaction determined separately.* For purposes of section 3.02(6)(a) of this notice, each component transaction of a larger transaction is examined separately for qualification as a *Covered Recognition Transaction* (for example, recognition treatment of a liability assumption component under § 357 and a transfer component under § 361(c)(3) are evaluated separately for determin-

ing qualification of each component as a *Covered Recognition Transaction*, notwithstanding that each component could be a component transaction of a larger transaction that includes Covered Nonrecognition Transactions under §§ 368(a)(1)(D) and 355). Because Covered Recognition Transaction status requires recognition treatment for Federal income tax purposes, the treatment of a component transaction as a Covered Recognition Transaction may be affected by the Federal income tax consequences of any other component transaction of the larger transaction as well as all other component transactions of the larger transaction (for example, taking into account all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine). See section 3.03(3)(e) of this notice (*Example 5*).

(7) *Covered Transaction.* The term *Covered Transaction* means a Covered Recognition Transaction or a Covered Nonrecognition Transaction (as appropriate).

(8) *Distributing AFS Group.* The term *Distributing AFS Group* means one or more chains of entities connected through ownership with a Common Parent Corporation that—

(a) composes or compose an AFS Group,

(b) is or are a Party to a Covered Transaction, and

(c) is or are treated on its AFS as the distributor of the stock of Controlled (for example, a *spinor* under the Accounting Standards Codification).

(9) *Party.* The term *Party* means, with regard to a Covered Transaction—

(a) a Controlled,

(b) a Distributing AFS Group,

(c) a partnership,

(d) a corporate partner transferring to, or receiving property from, a partnership in a Covered Transaction,

(e) a Target,

(f) a Target AFS Group, or

(g) an Acquirer AFS Group.

(10) *Section 108(b) Reduction Amount.* The term *Section 108(b) Reduction Amount* means the amount of excluded COD income that results in a reduction of tax attributes under § 108(b) or § 1.1502-28 (that is, the total amount of excluded COD income, minus the “black hole ex-

cluded COD income” described in section 2.02(3) of this notice).

(11) *Target.* The term *Target* means one corporation, or one or more chains of entities connected through ownership with a Common Parent Corporation, that—

(a) composes or compose a portion of a Target AFS Group (as defined in section 3.02(12) of this notice), and

(b) is or are treated as the Party that is acquired on the AFS of the Target AFS Group (for example, an *acquiree* under the Accounting Standards Codification).

(12) *Target AFS Group.* The term *Target AFS Group* means a corporation, or one or more chains of entities connected through ownership with a Common Parent Corporation, that—

(a) composes or compose an AFS Group, and

(b) is or are treated as—

(i) the Party that is acquired on the AFS of the Target AFS Group (for example, an *acquiree* under the Accounting Standards Codification), or

(ii) the AFS Group from which a Target is acquired on the AFS of the Target AFS Group.

(13) *Test Group.* The term *Test Group* means, as appropriate—

(a) all persons treated as a single employer under § 52(a) (as defined, with certain modifications, by § 1563(a)) or § 52(b) or the Treasury regulations under § 52(b), or

(b) all entities included in a foreign-parented multinational group, as defined in § 59(k)(2)(B).

(14) *Three-Taxable-Year Period.* The term *Three-Taxable-Year Period* has the meaning given the term in section 2.01(4)(b)(i) of this notice.

.03 *AFSI Consequences of Covered Nonrecognition Transactions.* For purposes of calculating AFSI, if there is a Covered Nonrecognition Transaction:

(1) *Adjustment of financial accounting gain or loss.*

(a) *Financial accounting treatment conforms to Federal income tax treatment.* Any financial accounting gain or loss resulting from the application of the accounting standards used to prepare the AFS of a Party to the Covered Nonrecognition Transaction is not taken into account solely for purposes of calculating the AFSI of the Party for the one or more

taxable years in which the AFS of the Party takes into account the Covered Nonrecognition Transaction.

(b) *Scope of rule.* The rule set forth in section 3.03(1)(a) of this notice applies solely to the AFSI consequences that result directly from the Covered Nonrecognition Transaction for the Party's taxable year in which the AFS of the Party takes into account that transaction. For general rules regarding the AFSI consequences of Covered Transactions (including Covered Nonrecognition Transactions and Covered Recognition Transactions) with regard to each Party's Three-Taxable-Year Period, see section 3.04 of this notice.

(2) *Corresponding adjustments to basis of transferred property on an AFS.* With regard to any property transferred to a Party as part of a Covered Nonrecognition Transaction described in section 3.03(1)(a) of this notice, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that Covered Nonrecognition Transaction is not taken into account solely for purposes of computing the AFSI of the Party receiving the transferred property with regard to any taxable year of that Party.

(3) *Examples.* The following examples illustrate the rules set forth in sections 3.03(1) and (2) of this notice. Each Party to a Covered Transaction described in these examples uses the Accounting Standards Codification (that is, U.S. GAAP) for purposes of preparing the Party's AFS. In addition, the AFS of each Party takes into account each Covered Transaction described in these examples in the taxable year in which the transaction occurs. Lastly, each Party's taxable year and accounting period is based on the calendar year.

(a) *Example 1 – Covered Nonrecognition Transaction Involving Acquirer AFS Group, Target AFS Group, and Target—(i) Facts.* Acquirer AFS Group and Target AFS Group, of which Target is a member, are unrelated. In the 2022 taxable year of Acquirer AFS Group and Target AFS Group, Acquirer AFS Group acquires Target solely in exchange for stock through a merger of Target into a member of Acquirer AFS Group that qualifies as a reorganization described in § 368(a)(1)(A) (Target Merger). On the AFS of Target AFS Group and the AFS of Acquirer AFS Group for the 2022 taxable year, the Target Merger results in financial accounting gain

and corresponding increases in the financial accounting basis of the assets received by each Party (that is, Acquirer AFS Group and Target AFS Group) in the transaction.

(ii) *Analysis.* To determine AFSI, neither Target AFS Group nor Acquirer AFS Group take into account the financial accounting gain (that otherwise would have resulted from the application of the accounting standards used to prepare each AFS Group's AFS) to the Target Merger for the 2022 taxable year. See section 3.03(1)(a) and (b) of this notice. This adjustment to financial accounting gain results from the Target Merger's qualification as a Covered Nonrecognition Transaction. See section 3.03(1)(a) of this notice. Each increase in financial accounting basis of the assets received by Target AFS Group and Acquirer AFS Group in the Target Merger (that otherwise would have resulted from the application of the accounting standards used to prepare each AFS Group's AFS) is not taken into account for AFSI purposes. See section 3.03(2) of this notice.

(b) *Example 2 – Disposition of Assets Acquired in Covered Nonrecognition Transaction—(i) Facts.* The facts are the same as in section 3.03(3)(a) of this notice (Example 1), except for the following. During Acquirer AFS Group's 2023 taxable year, a portion of the assets that Acquirer AFS Group received from Target AFS Group (Target Assets) in the Target Merger is sold by Acquirer AFS Group (Target Asset Sale). In the absence of the application of section 3.03(2) of this notice, the basis of those Target Assets would have been increased to fair market value on the AFS of Acquirer AFS Group as a result of the Target Merger.

(ii) *Analysis.* To determine the AFSI of Acquirer AFS Group for the 2023 taxable year, Acquirer AFS Group must treat its financial accounting basis in the Target Assets as equal to the financial accounting basis of those assets held by the transferor member of Target AFS Group immediately prior to the Target Merger (that is, a transferred financial accounting basis). See section 3.03(2) of this notice; cf. § 362(b). Therefore, solely for purposes of determining the AFSI of Acquirer AFS Group for the 2023 taxable year, Acquirer AFS Group must treat the Target Asset Sale as resulting in financial accounting gain equal to the difference between the financial accounting value of the Target Assets on the date of the sale and the transferred financial accounting basis of those assets (as adjusted for events subsequent to the Target Merger and any other relevant AFSI adjustments, such as those described in section 4.07 of this notice).

(c) *Example 3 – Covered Nonrecognition Transaction Involving Distributing AFS Group and Controlled—(i) Facts.* On January 1, 2022, the parent corporation of Distributing AFS Group (Distributing) contributes property to a newly formed Controlled in exchange for Controlled stock, Controlled's assumption of certain Distributing liabilities (Controlled Liability Assumption), Controlled cash, and Controlled securities (collectively, the Contribution). Pursuant to a plan of reorganization that includes the Contribution, Distributing distributes Controlled stock to

certain shareholders of Distributing throughout the year in exchange for Distributing stock (collectively, the Staggered Split-Off Distribution). The Contribution and Staggered Split-Off Distribution, together, qualify for nonrecognition treatment (i) for Distributing under §§ 368(a)(1)(D) and 355, 357, and 361, and (ii) for Controlled under § 1032(a). Pursuant to that plan of reorganization, Distributing transfers the Controlled cash and Controlled securities to Distributing's creditors (Cash for Debt Exchange and Debt for Debt Exchange, respectively) in transactions that qualify Distributing for nonrecognition treatment under §§ 361(b)(3) and (c)(3), respectively (collectively, the Deleveraging Transactions). On the AFS of Distributing AFS Group and Controlled, each of the transactions described in this section 3.03(3)(c)(i) results in financial accounting gain and corresponding increases in the financial accounting basis of the assets received by Controlled, respectively.

(ii) *Analysis.* In determining AFSI, Distributing does not take into account any financial accounting gain that otherwise would result from the application of the accounting standards used to prepare the Distributing AFS Group's AFS to any of the Contribution, Controlled Liability Assumption, Staggered Split-Off Distribution,² or Deleveraging Transactions (together, the Controlled Split-Off) for the 2022 taxable year. See section 3.03(1)(a) and (b) of this notice. This adjustment to financial accounting gain results from the qualification of each of those transactions as a Covered Nonrecognition Transaction. See section 3.03(1)(a) of this notice. The analysis in this section 3.03(3)(c) would not be affected if a creditor of Distributing were to recognize any gain for Federal income tax purposes in the Controlled Split-Off.

(d) *Example 4 – Covered Recognition Transaction Involving Distributing AFS Group—(i) Facts.* The facts are the same as in section 3.03(3)(c) of this notice (Example 3), except for the following. During Distributing AFS Group's 2022 taxable year, Distributing fails to transfer the Controlled securities to Distributing's creditors in a transaction that qualifies Distributing for nonrecognition treatment under § 361(c)(3). Accordingly, the Debt for Debt Exchange is a Covered Recognition Transaction for the 2022 taxable year.

(ii) *Analysis.* In determining AFSI, Distributing does not take into account any financial accounting gain that otherwise would result from the application of the accounting standards used to prepare the Distributing AFS Group's AFS to any of the Contribution, Controlled Liability Assumption, Cash for Debt Exchange, or Staggered Split-Off Distribution for the 2022 taxable year. See section 3.03(1)(a) and (b) of this notice. This adjustment to financial accounting gain results from the qualification of each of those transactions as a Covered Nonrecognition Transaction (which are component transactions of the Controlled Split-Off). See section 3.03(1)(a) of this notice. However, Distributing AFS Group must take into account, for the 2022 taxable year, any financial accounting gain that would result from applying the accounting standards used to prepare the

²A "split-off" generally consists of a non-pro rata distribution by Distributing of stock of a Controlled in which Distributing shareholders surrender some or all of their stock in Distributing in exchange for that Controlled stock. In contrast, a "spin-off" generally consists of a pro rata distribution of Controlled stock by Distributing to its shareholders with respect to their stock in Distributing.

Distributing AFS Group's AFS to the Debt for Debt Exchange because that transaction is a Covered Recognition Transaction. *See* section 3.03(1)(a) and (b) of this notice. Accordingly, for purposes of determining AFSI, the financial accounting basis of the assets of Controlled are increased (on the AFS of Controlled) by an amount corresponding to the financial accounting gain that resulted from the Debt for Debt Exchange (in other words, section 3.03(2) does not apply to the Debt for Debt Exchange). *See* section 3.03(1)(a) of this notice.

(e) *Example 5 – Covered Recognition Transaction under Subchapter K—(i) Facts.* Partner A contributes property to existing Partnership in a transaction purporting to qualify for nonrecognition treatment under § 721 (Contribution). Following the Contribution, Partnership distributes cash to Partner A in a transaction purporting to qualify for nonrecognition treatment under § 731 (Distribution). Section 707(a)(2)(B) and § 1.707-3 apply to the Contribution and Distribution to treat those transactions together as a part sale, part contribution of the property by Partner A to Partnership.

(ii) *Analysis.* The Contribution by Partner A and the Distribution by Partnership result in the recognition of gain or loss for Federal income tax purposes due to the application of § 707(a)(2)(B) and § 1.707-3. Qualification of the Contribution and the Distribution (each, a component transaction of a larger transaction) as a Covered Nonrecognition Transaction is determined based on the Federal income tax consequences of all other component transactions of the larger transaction. *See* section 3.02(5)(b) of this notice. In other words, the application of § 707(a)(2)(B) and § 1.707-3 to both component transactions of the larger transaction, which treats them together as a part taxable exchange under § 1001 and a part nontaxable contribution, results in the Contribution and Distribution being treated as a Covered Recognition Transaction. *See* section 9.01(1)(b) of this notice for a request for comments regarding Covered Transactions in which, for Federal income tax purposes, gain or loss is recognized in part.

.04 Consequences of All Covered Transactions. For purposes of determining the AFSI of a Party for the Three-Taxable-Year Period:

(1) *Covered Transactions Involving Solely an Acquirer AFS Group and a Target AFS Group.* If an Acquirer AFS Group acquires a Target AFS Group through a Covered Transaction that creates a Test Group comprising the Target AFS Group (or the assets thereof) and the Acquirer AFS Group—

(a) the applicable corporation status (if that status existed immediately prior to the Covered Transaction) of the Target AFS Group terminates, and

(b) the AFSI of the Target AFS Group for each year of the Target AFS Group's Three-Taxable-Year Period is combined with the AFSI of the Acquirer AFS Group

for each year of the Acquirer AFS Group's Three-Taxable-Year Period.

(2) *Covered Transactions Involving Solely an Acquirer AFS Group and a Target.* If an Acquirer AFS Group acquires a Target in a Covered Transaction that creates a Test Group comprising the Target (or the assets thereof) and the Acquirer AFS Group—

(a) the applicable corporation status (if that status existed immediately prior to the Covered Transaction) of the Target terminates,

(b) the AFSI of the Target for the Three-Taxable-Year Period of the Target is determined based on the Target's allocated portion of the Target AFS Group's total AFSI, determined based on any reasonable allocation method of the Target AFS Group until the issuance of the forthcoming proposed regulations, which will provide a required allocation method (*see* section 9.01(1)(e) of this notice),

(c) the AFSI of the Target for each year of the Target's Three-Taxable-Year Period is combined with the AFSI of the Acquirer AFS Group for each year of the Acquirer AFS Group's Three-Taxable-Year Period, and

(d) the AFSI of the Target AFS Group for each year of the Target AFS Group's Three-Taxable-Year Period is not reduced by the allocation of AFSI to the Target (as required by section 3.04(2)(b) of this notice), or otherwise affected by the Acquirer AFS Group's acquisition of Target through the Covered Transaction.

(3) *Covered Transactions Involving Distributing AFS Group and Controlled.* If a Distributing AFS Group distributes the stock of Controlled to the shareholders of the Distributing AFS Group's parent corporation in a Covered Transaction—

(a) the applicable corporation status (if that status existed immediately prior to the Covered Transaction) of Controlled terminates,

(b) the AFSI of Controlled for the Three-Taxable-Year Period of Controlled is determined based on Controlled's allocated portion of the Distributing AFS Group's total AFSI, determined based on any reasonable allocation method of the Distributing AFS Group until the issuance of the forthcoming proposed regulations, which will provide a required allocation

method (*see* section 9.01(1)(f) of this notice), and

(c) the AFSI of the Distributing AFS Group for each year of the Distributing AFS Group's Three-Taxable-Year Period is not reduced by the allocation of AFSI to Controlled (as required by section 3.04(3)(b) of this notice), or otherwise affected by the Distributing AFS Group's distribution of the stock of Controlled through the Covered Transaction.

(4) *Examples.* The following examples illustrate the rules set forth in sections 3.04(1) through (3) of this notice. Each Party to a Covered Transaction described in these examples uses the Accounting Standards Codification (that is, U.S. GAAP) for purposes of preparing the Party's AFS. In addition, the AFS of each Party takes into account each Covered Transaction described in these examples in the taxable year in which such transaction occurs. Lastly, each Party's taxable year and accounting period is based on the calendar year.

(a) *Example 6 – Covered Nonrecognition Transaction Involving Acquirer AFS Group and Target—(i) Facts.* The facts are the same as in section 3.03(3)(a) of this notice (Example 1), except for the following. For taxable years 2020, 2021, and 2022, Target AFS Group has AFSI of \$1.3 billion, \$1.2 billion, and \$1.1 billion, respectively. For those taxable years, Acquirer AFS Group has AFSI of \$800 million, \$900 million, and \$1 billion, respectively. Pursuant to a reasonable allocation method, Target AFS Group allocates to Target \$50 million, \$100 million, and \$200 million of AFSI for taxable years 2020, 2021, and 2022, respectively. *See* section 3.04(2)(b) of this notice. As a result of the Target Merger, Acquirer AFS Group and Target compose a Test Group.

(ii) *Analysis.* As a result of the Target Merger, Acquirer AFS Group (which, as a result, includes Target) is an applicable corporation for Acquirer AFS Group's 2023 taxable year. Specifically, for purposes of applying the general AFSI test to Acquirer AFS Group for Acquirer AFS Group's 2022 taxable year, Target's allocated AFSI is combined with Acquirer AFS Group's AFSI. As a result, Acquirer AFS Group has an average AFSI in excess of \$1 billion. Specifically, the Acquirer AFS Group has an average AFSI of \$1.017 billion, which equals \$3.05 billion (that is, \$850 million (\$800 million + \$50 million) for taxable year 2020, \$1 billion (\$900 million + \$100 million) for taxable year 2021, and \$1.2 billion (\$1 billion + \$200 million) for taxable year 2022) ÷ 3 years. *See* section 3.04(2)(c) of this notice. Target AFS Group also is an applicable corporation for its 2023 taxable year because its allocation of AFSI to Target, and any other aspect of the Target Merger, does not affect the AFSI of Target AFS Group prior to its 2023 taxable year. *See* section 3.04(2)(d) of this notice.

(b) *Example 7 – Covered Transactions Involving Distributing AFS Group and Controlled—(i) Facts.* The facts are the same as in section 3.03(3)(c) of this notice (Example 3), except for the following. For taxable years 2020, 2021, and 2022, Distributing AFS Group has AFSI of \$2.1 billion, \$2.0 billion, and \$1.9 billion, respectively. Pursuant to a reasonable allocation method, Distributing AFS Group allocates to Controlled \$950 million, \$1.2 billion, and \$1 billion of AFSI for taxable years 2020, 2021, and 2022, respectively. See section 3.04(3)(b) of this notice. In addition to the amount of AFSI allocated to Controlled for 2022, Controlled has standalone AFSI of \$300 million in 2022.

(ii) *Analysis.* As a result of the Controlled Split-Off, Controlled is an applicable corporation for Controlled's 2023 taxable year. For purposes of applying the general AFSI test to Controlled for Controlled's 2022 taxable year, Controlled's allocated AFSI results in Controlled having an average AFSI in excess of \$1 billion. Specifically, the Controlled AFS Group has an average AFSI of \$1.15 billion, which equals \$3.45 billion (that is, \$950 million for taxable year 2020, \$1.2 billion for taxable year 2021, and \$1.3 billion (\$1 billion + \$300 million) for taxable year 2022) ÷ 3 years. See section 3.04(3)(b) of this notice. Distributing AFS Group also is an applicable corporation for its 2023 taxable year because its allocation of AFSI to Controlled, and any other aspect of the Controlled Split-Off, does not affect the AFSI of Distributing AFS Group prior to its 2023 taxable year. See section 3.04(3)(c) of this notice.

.05 *Treatment of Tax Consolidated Groups for Purposes of the CAMT.* A tax consolidated group is treated as a single entity for purposes of calculating AFSI for determining applicable corporation status and for purposes of calculating AFSI for CAMT liability.

.06 *AFSI Consequences of Excluded COD Income.* To the extent that a discharge of indebtedness results in excluded COD income to an AFS Group for Federal income tax purposes, but results in gain to the AFS Group on the AFS of the AFS Group:

(1) *Adjustment of financial accounting gain.* The financial accounting gain resulting from application of the accounting standards used to prepare the AFS of the AFS Group to the discharge of indebtedness that is equal to the amount of excluded COD income (for Federal income tax purposes) of the AFS Group is not taken into account for purposes of calculating the AFSI of that AFS Group for the taxable year in which the discharge of indebtedness occurs.

(2) *Corresponding adjustments to CAMT attributes of AFS Group.* If financial accounting gain resulting from

a discharge of indebtedness is not taken into account under section 3.06(1) of this notice for purposes of calculating the AFSI of an AFS Group, the AFS Group's CAMT attributes must be reduced to the extent of the Section 108(b) Reduction Amount under the principles of, including taking into account the ordering provided by, § 108(b) and § 1017.

(3) *Example 8 – Excluded COD of tax consolidated group—(a) Facts.* Parent is the common parent of a tax consolidated group (Parent Tax Consolidated Group), which also is an AFS Group (Parent AFS Group). There is no member of Parent AFS Group other than members of Parent Tax Consolidated Group. During its 2022 taxable year, Parent AFS Group emerges from bankruptcy. All members of Parent AFS Group were under the jurisdiction of the bankruptcy court. As a result of the bankruptcy reorganization, \$1,000x of Parent AFS Group debt is discharged, the entire amount of which results in excluded COD. However, the Section 108(b) Reduction Amount of Parent AFS Group is \$850x. A group of former creditors of Parent AFS Group owns 100 percent of the outstanding stock of Parent. None of the shareholders of Parent controls Parent for purposes of preparing the shareholders' respective AFS. Therefore, Parent AFS Group is not consolidated into any other AFS Group following Parent AFS Group's emergence from bankruptcy. On Parent AFS Group's AFS, all \$1,000x of the excluded COD is taken into account as financial accounting gain.

(b) *Analysis.* For purposes of determining AFSI for the 2022 taxable year, Parent AFS Group does not take into account any financial accounting gain that otherwise would result from the application of the accounting standards used to prepare the Parent AFS Group's AFS to any of the \$1,000x of excluded COD. See section 3.06(1) of this notice. The CAMT attributes of Parent AFS Group must be reduced by an amount equal to the amount of Parent AFS Group's Section 108(b) Reduction Amount (that is, \$850x). See section 3.06(2) of this notice. Parent AFS Group must reduce those CAMT attributes under the principles of, including taking into account the ordering provided by, § 108(b) and § 1017. See *id.*

.07 *AFSI Consequences of Emergence from Bankruptcy.* To the extent that the emergence from bankruptcy of an AFS Group results in gain or loss to the AFS Group on its AFS:

(1) *Adjustment of financial accounting gain or loss.* The financial accounting gain or loss resulting from application of the accounting standards used to prepare the AFS of the AFS Group to the emergence from bankruptcy by the AFS Group is not taken into account for purposes of calculating the AFSI of that AFS Group for the taxable year in which the emergence from bankruptcy occurs.

(2) *Corresponding adjustments to basis of transferred property on an AFS.* With

regard to any property of a Party emerging from bankruptcy in a transaction described in section 3.07(1) of this notice, any increase or decrease in the financial accounting basis of that property on the AFS of the Party resulting from that emergence from bankruptcy (other than as a result of the excluded COD income reduction under the principles of, including taking into account the ordering provided by, § 108(b) and § 1017) is not taken into account for purposes of computing AFSI with regard to any taxable year of that Party. That is, to determine the AFSI of an AFS Group described in this section 3.07(2), financial accounting basis of a Party (that is a member of that AFS Group) emerging from a bankruptcy equals the financial accounting basis of those assets of the Party immediately prior to the Party's emergence from bankruptcy, as adjusted under section 3.06(2) of this notice.

SECTION 4. DEPRECIATION ADJUSTMENTS

.01 *Purpose.* The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will be consistent with the guidance provided in this section 4. The Treasury Department and the IRS are providing this interim guidance to facilitate the application of the depreciation adjustment rules in § 56A(c)(13) prior to the issuance of the forthcoming proposed regulations.

.02 *Defined Terms.* For purposes of this section 4:

(1) *Covered Book COGS Depreciation.* The term *Covered Book COGS Depreciation* means depreciation expense, impairment loss, or impairment loss reversal that is taken into account as cost of goods sold in the net income or loss set forth on the taxpayer's AFS with respect to Section 168 Property (as defined in section 4.02(5) of this notice).

(2) *Covered Book Depreciation Expense.* The term *Covered Book Depreciation Expense* means depreciation expense, impairment loss, or impairment loss reversal other than Covered Book COGS Depreciation that is taken into account in the net income or loss set forth on the taxpayer's AFS with respect to Section 168 Property (as defined in section 4.02(5) of this notice).

(3) *Covered Book Expense*. The term *Covered Book Expense* means an amount, other than Covered Book COGS Depreciation and Covered Book Depreciation Expense, that is—

(a) recognized as an expense or loss in the net income or loss set forth on the taxpayer's AFS, and

(b) reflected in the unadjusted depreciable basis, as defined in § 1.168(b)-1(a)(3), of Section 168 Property (as defined in section 4.02(5) of this notice) for Federal income tax purposes.

(4) *Deductible Tax Depreciation*. The term *Deductible Tax Depreciation* means Tax Depreciation (as defined in section 4.02(7) of this notice) that is allowed as a deduction in computing taxable income.

(5) *Section 168 Property*. The term *Section 168 Property* means property to which § 168 applies, as described in section 4.04 of this notice.

(6) *Tax COGS Depreciation*. The term *Tax COGS Depreciation* means Tax Depreciation (as defined in section 4.02(7) of this notice) that is capitalized to inventory under § 263A and recovered as part of cost of goods sold in computing gross income under § 61.

(7) *Tax Depreciation*. The term *Tax Depreciation* means depreciation deductions allowed under § 167, with respect to Section 168 Property.

.03 *Adjustments for Depreciation (Including Depreciation Capitalized to Inventory)*. For purposes of § 56A(c)(13), AFSI is—

(1) reduced by Tax COGS Depreciation, but only to the extent of the amount recovered as part of cost of goods sold in computing taxable income for the taxable year,

(2) reduced by Deductible Tax Depreciation, but only to the extent of the amount allowed as a deduction in computing taxable income for the taxable year,

(3) adjusted to disregard Covered Book COGS Depreciation, Covered Book Depreciation Expense, and Covered Book Expense, and

(4) adjusted for other items as provided in guidance published in the Internal Revenue Bulletin (see § 601.601(d) of the Statement of Procedural Rules (26 CFR part 601)).

.04 *Property to Which § 168 Applies (Section 168 Property)*.

(1) *In general*. For purposes of § 56A(c)(13), property to which § 168 applies consists of the following:

(a) MACRS property, as defined in § 1.168(b)-1(a)(2), that is depreciated under § 168;

(b) Computer software that is qualified property as defined in §§ 1.168(k)-1(b)(1) or 1.168(k)-2(b)(1), as applicable, and depreciated under § 168; and

(c) Other property depreciated under § 168 that is (i) qualified property as defined in § 1.168(k)-2(b)(1) and that is (ii) described in § 1.168(k)-2(b)(2)(i)(E), (F), or (G).

(2) *Section 56A(c)(13) applies only to portion depreciated under §§ 167 and 168*. For purposes of § 56A(c)(13), property to which § 168 applies includes only the portion of the cost of property described in section 4.04(1) of this notice that is depreciated under §§ 167 and 168. For example, if a portion of the cost of a property described in section 4.04(1)(c) of this notice is deducted under § 181, and the remainder of the cost of the property is depreciated under §§ 167 and 168, only the portion of the cost of property depreciated under §§ 167 and 168 is considered property to which § 168 applies for purposes of § 56A(c)(13). Further, if a taxpayer does not depreciate any portion of a property under § 168, the property is not property to which § 168 applies for purposes of § 56A(c)(13), and thus, not subject to adjustment under § 56A(c)(13). For example, if the taxpayer elects out of the additional first year depreciation deduction under § 168(k) for property described in section 4.04(1)(b) or (c) of this notice, then AFSI is not adjusted under § 56A(c)(13) with respect to such property because § 168 does not apply to such property.

.05 *Repair deductions*. Section 56A(c)(13) applies only to Section 168 Property. For example, if a taxpayer deducts an expenditure as a repair for Federal income tax purposes but capitalizes the expenditure as an improvement for AFS purposes, § 56A(c)(13) does not apply because the expenditure does not give rise to Section 168 Property. For purposes of determining the appropriate asset in order to ascertain if there is Section 168 Property, the unit of property determination under § 1.263(a)-3(e) does not apply. Instead,

taxpayers should follow § 168 and the regulations under § 168. See § 1.168(i)-8(c)(4).

.06 *Property placed in service in taxable years beginning before January 1, 2023*. Section 56A(c)(13) applies to Section 168 Property placed in service in any taxable year, including taxable years beginning before January 1, 2023.

.07 *AFSI adjustments for dispositions*. If a taxpayer disposes of Section 168 Property, the taxpayer must adjust AFSI to redetermine any gain or loss taken into account in the net income or loss set forth on the taxpayer's AFS with respect to such disposition (including a gain or loss of zero) by adjusting the AFS basis of such property to take into account all current and prior § 56A(c)(13) adjustments, including those that would have been made in taxable years prior to the effective date of the CAMT had the CAMT applied in those years.

.08 *Example*. The following example illustrates the rules set forth in sections 4.06 and 4.07 of this notice.

(1) *Facts*. Taxpayer is an applicable corporation for the calendar year ending December 31, 2023. On January 1, 2018, Taxpayer purchased and placed in service Property A, a Section 168 Property, at a cost of \$1,000x. Property A qualified for, and Taxpayer claimed, the 100-percent additional first year depreciation deduction allowable under § 168(k) for its taxable year ending December 31, 2018. For AFS purposes, Taxpayer depreciates Property A over 40 years on a straight-line method and recognized \$25x (\$1,000x cost / 40 years) of Covered Book Depreciation Expense in 2018 and each year thereafter until it sold Property A on January 1, 2024 for \$900x. For 2024, Taxpayer takes into account \$50x of net gain for the sale of Property A in the net income or loss set forth on its AFS (\$900x proceeds - \$850x of AFS basis (\$1,000x cost - \$150x accumulated Covered Book Depreciation Expense as of January 1, 2024)).

(2) *Analysis for taxable year 2023*. In determining AFSI for the taxable year ending December 31, 2023, Taxpayer does not have any Deductible Tax Depreciation or Tax COGS Depreciation in computing taxable income with respect to Property A, and thus, the adjustment under section 4.03(1) and (2) of this notice would be zero. In addition, Taxpayer would adjust AFSI under section 4.03(3) of this notice to disregard the \$25x of Covered Book Depreciation Expense with respect to Property A.

(3) *Analysis for taxable year 2024*. To determine the AFSI adjustment for the gain or loss from the sale of Property A under section 4.07 of this notice, Taxpayer must adjust the AFS basis to take into account the cumulative § 56A(c)(13) adjustments, starting from the date Property A was placed-in-service. Accordingly, the adjusted basis of Property A for AFSI purposes is zero (\$850x AFS basis + \$150x

accumulated Covered Book Depreciation Expense - \$1,000x of accumulated Tax Depreciation). Thus, the redetermined gain on the sale of Property A for AFSI purposes is \$900x (\$900x proceeds - \$0 adjusted AFSI basis).

SECTION 5. SAFE HARBOR METHOD FOR DETERMINING APPLICABLE CORPORATION STATUS

.01 *Purpose.* The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will be consistent with the guidance provided in this section 5. The Treasury Department and the IRS are providing this interim guidance to provide corporations with a safe harbor method for determining whether they are an applicable corporation for the first taxable year beginning after December 31, 2022.

.02 *Definition of AFS Consolidation Entries.* For purposes of this section 5, the term *AFS Consolidation Entries* means the financial accounting journal entries that are made for AFS purposes in order to present the financial results of an AFS Group (as defined in section 2.01(3)(c)(i) of this notice) as though all members of the AFS Group were a single company, including journal entries to eliminate transactions between members of such group.

.03 *Simplified method for determining applicable corporation status.*

(1) *In general.* For the first taxable year beginning after December 31, 2022, a corporation may choose to apply the safe harbor method described in section 5.03(2) of this notice (simplified method) in lieu of the rules in §§ 59(k)(1) and (2) for purposes of determining whether it is an applicable corporation under § 59(k)(1).

(2) *Simplified method.* Under the simplified method, a corporation determines whether it is an applicable corporation by applying the rules in § 59(k)(1) and (2) with the following modifications:

(a) The AFSI test in § 59(k)(1)(B)(i) (including for purposes of § 59(k)(1)(B)(ii)(I)) is applied by substituting “\$500,000,000” for “\$1,000,000,000.”

(b) The AFSI test in § 59(k)(1)(B)(ii)(II) is applied by substituting “\$50,000,000” for “\$100,000,000.”

(c) AFSI is determined –

(i) except as provided in section 5.03(2)(c)(ii) of this notice, without regard to the

adjustments set forth in § 56A(c) and (d) other than those set forth in § 56A(c)(2)(A), (c)(2)(B), and (c)(5), except that in applying § 59(k)(1)(B)(ii)(II), the adjustment in § 56A(c)(4) also applies, and

(ii) after taking into account AFS Consolidation Entries except those that eliminate transactions between persons not treated as a single employer under § 52(a) or (b).

(d) For a corporation that has an AFS that covers a period (AFS year) that differs from its taxable year—

(i) Section 59(k)(1)(B)(i) and (ii)(I) are applied by substituting “3-AFS-year period ending during such taxable year” for “3-taxable-year period ending with such taxable year” in each place those phrases appear, and

(ii) Section 59(k)(1)(E) is applied by substituting “AFS year” for “taxable year” and “3-AFS years” for “3-taxable years” in each place those phrases appear.

(3) *Examples.* The following examples illustrate the rules set forth in section 5.03(2)(c) and (d) of this notice.

(a) *Example 1 – AFS Consolidation Entries example.* The following example illustrates the rule set forth in section 5.03(2)(c) of this notice.

(i) *Facts.* Corporations A, B, and C are U.S. Corporations that are members of an AFS Group (ABC group). A and B (but not C) are treated as a single employer under § 52(a). A, B, and C choose to apply the simplified method described in section 5.03(2) of this notice. During the 2022 taxable year, A provides services to B and C. For purposes of the 2022 AFS for the ABC group, AFS Consolidation Entries are made to eliminate income and expense from the provision of service transactions between A and B, and between A and C.

(ii) *Analysis.* Pursuant to section 5.03(2)(c) of this notice and for purposes of applying the simplified method described in section 5.03(2) of this notice, the AFSI of A and B for the 2022 taxable year is determined by taking into account the AFS Consolidation Entries that eliminate the income and expense from the transactions between A and B. However, the AFS Consolidation Entries that eliminate income and expense from the provision of service transactions between A and C are not taken into account for purposes of determining the AFSI of A, B, and C because A and C are not treated as a single employer under § 52(a).

(b) *Example 2 – Mismatched tax and AFS year example.* The following example illustrates the rule set forth in section 5.03(2)(d) of this notice.

(i) *Facts.* Corporation uses the calendar year as its taxable year and has a fiscal AFS year that ends on September 30. Corporation has been in existence since before calendar year 2020 and has never had a short taxable year or short AFS year. Corporation chooses to use the simplified method described in section 5.03(2) of this notice.

(ii) *Analysis.* In determining whether Corporation is an applicable corporation for its taxable year ending December 31, 2023, Corporation applies § 59(k)(1)(B) (as modified by section 5.03(2) of this notice) by using the AFSI (as determined under section 5.03(2)(c) of this notice) for the 3-AFS-year period ending during its taxable year ending December 31, 2022. That is, Corporation uses AFSI from the AFS years that ended September 30, 2020, September 30, 2021, and September 30, 2022.

(4) *Effect of not meeting the safe harbor.* If a corporation applies the simplified method described in section 5.03(2) of this notice for its first taxable year beginning after December 31, 2022, and determines that its AFSI (as determined under section 5.03(2) of this notice) exceeds the relevant simplified method thresholds set forth in section 5.03(2)(a) and (b) of this notice, for example, because it has AFSI in excess of \$500 million and is not described in § 59(k)(2), then the corporation will be an applicable corporation for such year only if it is determined to be an applicable corporation under § 59(k)(1) (determined without regard to the modifications described in section 5.03(2) of this notice).

SECTION 6. AFSI ADJUSTMENTS WITH RESPECT TO CERTAIN CREDITS

.01 *Purpose.* The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will be consistent with the guidance provided in this section 6. The Treasury Department and the IRS are providing this interim guidance to facilitate the ability of taxpayers to determine AFSI with respect to certain credits described in §§ 48D, 6417, and 6418.

.02 *Proceeds from certain credits excluded from AFSI.* AFSI is appropriately adjusted to disregard—

(1) any amount treated as a payment against the tax imposed by subtitle A pursuant to an election under §§ 48D(d) or 6417, provided that such amount (or portion thereof) is not otherwise disregarded under § 56A(c)(5),

(2) any amount received from the transfer of an eligible credit, as defined in § 6418(f)(1)(A), that is not includible in the gross income of the taxpayer by application of § 6418(b) or is treated as tax-exempt income under § 6418(c)(1)(A), provided that such amount (or portion thereof) is not otherwise disregarded under § 56A(c)(5), and

(3) any amount received pursuant to an election under §§ 48D(d)(2) or 6417(c) that is treated as tax-exempt income under §§ 48D(d)(2)(A)(i)(III) or 6417(c)(1)(C), provided that such amount is not otherwise disregarded under § 56A(c)(5).

SECTION 7. APPLICATION OF § 56A(c)(2)(D)(i) FOR PURPOSES OF DETERMINING APPLICABLE CORPORATION STATUS

.01 *Purpose.* The Treasury Department and the IRS anticipate that the forthcoming proposed regulations will be consistent with the guidance provided in this section 7. The Treasury Department and the IRS are providing this interim guidance to facilitate the ability of taxpayers to determine whether they are an applicable corporation under § 59(k)(1).

.02 *Adjustment to AFSI in § 56A(c)(2)(D)(i) is inapplicable in all circumstances for purposes of calculating AFSI in determining applicable corporation status.* The Treasury Department and the IRS understand there may be uncertainty among taxpayers as to whether the adjustment to AFSI in § 56A(c)(2)(D)(i) applies for purposes of determining whether a corporation that is a partner in a partnership (whether directly or indirectly) is an applicable corporation if such corporation and such partnership are not treated as a single employer under § 52(a) or (b). Section 59(k)(1)(D) provides that solely for purposes of determining whether a corporation is an applicable corporation, the AFSI of such corporation is determined without regard to § 56A(c)(2)(D)(i). Accordingly, the adjustment to AFSI under § 56A(c)(2)(D)(i) is inapplicable in all circumstances in determining applicable corporation status.

SECTION 8. APPLICABILITY DATES

It is anticipated that the forthcoming proposed regulations will provide that rules consistent with the rules described in sections 3 through 7 of this notice apply for taxable years beginning after December 31, 2022. Prior to the issuance of the proposed regulations, taxpayers may rely on the guidance provided in sections 3 through 7 of this notice.

SECTION 9. REQUEST FOR COMMENTS

.01 *Comments Regarding Guidance Provided in this Notice.* The Treasury Department and the IRS request comments on any questions arising from the interim guidance set forth in this notice. Commenters are encouraged to specify the issues on which additional guidance (including additional interim guidance) is needed most quickly, as well as the most important issues on which guidance is needed. In addition to general comments regarding the provisions of this notice, the Treasury Department and the IRS request comments to address the following specific questions:

(1) *AFSI and applicable corporation status resulting from certain transactions; tax consolidated groups (section 3 of this notice).*

(a) Should the definition of Covered Nonrecognition Transaction be expanded to include additional transactions? If so, to what extent should the AFSI consequences of each additional transaction be consistent with the rules addressing AFSI consequences of Covered Nonrecognition Transactions set forth in section 3.03 of this notice?

(b) How should Covered Transactions in which, for Federal income tax purposes, gain or loss is recognized in part be treated? Also, are there any AFSI consequences of Covered Transactions (in addition to the AFSI consequences addressed under section 3.03 of this notice) that also should be addressed by the forthcoming proposed regulations or additional interim guidance (for example, the receipt of cash or other property in acquisitive reorganizations)? For example, are there any circumstances in which attributes, in addition to basis, should be adjusted under these rules? *See* section 3.03(2) of this notice.

(c) Should any adjustments to AFS gain or loss be made to Covered Recognition Transactions carried out solely between or among members of a single AFS Group?

(d) In the case of an acquisitive Covered Recognition Transaction between two or more separate AFS Groups, what resulting adjustments to AFS gain or loss should be made to each AFS Group?

(e) How should a Target's allocated portion of the Target AFS Group's total

AFSI be calculated for purposes of determining the AFSI of an Acquirer AFS Group that acquires the Target in a Covered Transaction? *See* section 3.04(2)(b) of this notice.

(f) Is there any reason why a Controlled's allocated portion of the Distributing AFS Group's total AFSI should be calculated differently for purposes of determining the AFSI of the Controlled? *See* section 3.04(3)(b) of this notice.

(g) With regard to the rules provided in sections 3.06 and 3.07 of this notice that address the AFSI consequences of excluded COD income and an emergence from bankruptcy:

(i) What are the CAMT attributes that should be adjusted?

(ii) What methodology should be used to adjust the CAMT attributes (including the order in which those attributes should be adjusted)?

(iii) Are any transition rules necessary?

(h) Should the treatment of bankruptcy reorganizations for purposes of calculating AFSI depend on whether the bankruptcy reorganization is a recognition event for Federal income tax purposes? If so, what should be the methodology for calculating such AFSI?

(i) Should the rules addressing AFSI consequences of excluded COD income in section 3.06 of this notice be revised (1) to exclude all AFS gain associated with a cancellation of indebtedness when there is excluded COD income for the cancellation of indebtedness, and (2) to reduce CAMT attributes to the extent of such gain exclusion?

(j) Are there AFS consequences to bankruptcy reorganizations that should be addressed by the forthcoming proposed regulations or additional interim guidance that are not addressed by section 3.06 or 3.07 of this notice?

(2) *Depreciation adjustments (section 4 of this notice).*

(a) How should a taxpayer with Tax COGS Depreciation make the adjustments described in section 4.03 of this notice to ensure that—

(i) AFSI is reduced by only the amount of Tax COGS Depreciation that is recovered as part of cost of goods sold in computing taxable income for the taxable year, and

(ii) Covered Book COGS Depreciation is appropriately disregarded in determin-

ing AFSI for the year in which it is recovered as part of cost of goods sold?

(b) With respect to the issue described in section 9.01(2)(a) of this notice, should the taxpayer be permitted to make appropriate adjustments by applying the method(s) of accounting under § 263A that it uses for regular tax purposes?

.02 Comments Regarding Rules Not Included in this Notice. The Treasury Department and the IRS request comments on the CAMT generally and the issues that should be addressed in future guidance with respect to the CAMT. The Treasury Department and the IRS additionally request comments on the following specific CAMT issues not addressed by this notice:

(1) What, if any, additional guidance is needed regarding the scope of the exception in § 59(k)(1)(D) to the distributive share rule in § 56A(c)(2)(D)(i) applicable for purposes of determining applicable corporation status?

(2) How should the term “distributive share” of a partnership’s AFSI in § 56A(c)(2)(D)(i) be interpreted? Should the term be based on financial accounting principles or tax principles or both? How should a corporate partner’s distributive share be calculated for purposes of the CAMT?

(3) What, if any, other adjustments to AFSI should be made to carry out the principles of part II of subchapter K of chapter I of the Code? Should any exceptions apply to the Covered Nonrecognition Transaction rule for partnership transactions? If so, what are those exceptions?

(4) What transactions should be treated as a “change in ownership” (within the meaning of § 59(k)(1)(C)(i)(I))?

(5) What facts and circumstances should be considered relevant for determining whether a taxpayer remains an applicable corporation after a change in ownership?

(6) What duration (if any) should be required under § 59(k)(1)(C)(i)(II) before an applicable corporation should be treated as no longer an applicable corporation?

(7) In addition to a potential duration described in section 9.02(6) of this notice, what additional facts and circumstances should be considered relevant in determining whether an applicable corporation should continue to be treated as an applicable corporation?

(8) Are there situations in which AFSI is duplicated or omitted as a result of the application of § 52(a) and (b) under § 59(k)(1)(D)? If so, what are those situations and what guidance is needed to prevent the duplication or omission of AFSI in determining whether a corporation is an applicable corporation under § 59(k)(1)?

(9) What entities should be treated as predecessors of a taxpayer for purposes of § 59(k)(1)(E)?

(10) To what extent (if any) are predecessor concepts applicable to other areas of the CAMT (in addition to § 59(k)(1)(E)(iii))?

(11) What rules would be appropriate under new § 59(k)(2)(D)(i) regarding foreign-parented multinational groups?

(12) In the case of a financial deconsolidation of a member of an AFS Group, what adjustments to AFSI would be appropriate?

(13) Should principles provided in § 1.1502-21(c), or §§ 382 and 383 and § 1.1502-15, apply to limit the availability of CAMT attributes for purposes of calculating the tentative minimum tax? If so, to what extent?

(14) How should CAMT liability, financial statement net operating losses (as defined in § 56A(d)), and CAMT credits (under § 53) be allocated and used among members of a tax consolidated group?

(15) How should the CAMT attributes described in section 9.02(13) of this notice be allocated to departing members of a tax consolidated group?

(16) To what extent (if any) should items included in OCI in a taxpayer’s AFS be included in AFSI?

(17) The Treasury Department and the IRS understand that, for certain types of reinsurance contracts (those with embedded derivatives), there may be a mismatch between the treatment of investment assets and related liabilities for AFSI purposes. How and to what extent should adjustments be made to AFSI to address any such mismatch?

(18) To what extent should guidance provide adjustments to AFSI to disregard mark to market unrealized gains and losses that are otherwise included in AFSI? Should this depend on the extent to which the taxpayer marks to market the item for regular tax purposes?

(19) To what extent should guidance provide adjustments to include in AFSI mark to market unrealized gains and losses that are not otherwise included in AFSI? Should this depend on the extent to which the taxpayer marks to market the item for regular tax purposes?

(20) Should the rules under § 451(b)(5) be modified for purposes of determining the AFSI of a corporation included in an AFS Group? See § 56A(c)(2)(A).

.03 Procedures for Submitting Comments.

(1) *Deadline.* Written comments should be submitted by March 20, 2023. Consideration will also be given to any written comment submitted after March 20, 2023, though such comments may not be considered in the development of the forthcoming proposed regulations if such consideration would delay the issuance of the forthcoming proposed regulations.

(2) *Form and manner.* The subject line for the comments should include a reference to Notice 2023-7. All commenters are strongly encouraged to submit comments electronically. However, comments may be submitted in one of two ways:

(a) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2023-0001 in the search field on the [regulations.gov](http://www.regulations.gov) homepage to find this notice and submit comments); or

(b) By mail to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2023-7), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

(3) *Publication of comments.* The Treasury Department and the IRS will publish for public availability any comment submitted electronically and on paper to its public docket on [regulations.gov](http://www.regulations.gov).

SECTION 10. DRAFTING AND CONTACT INFORMATION

The principal authors of this notice are John M. Aramburu and James Yu of the Office of the Associate Chief Counsel (Income Tax & Accounting); William W. Burhop, Jeremy Aron-Dine, and John B. Lovelace of the Office of the Associate Chief Counsel (Corporate); and Yosef M. Koppel of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). Other personnel from the Treasury Department and the IRS participated in

its development. For further information regarding section 3 of this notice, please contact Mr. Aron-Dine or Mr. Lovelace at (202) 317-6848, or Mr. Burhop at (202) 317-5363; or Mr. Koppel at (202) 317-6850 (not toll-free numbers). For further information regarding new § 59(k)(2) (regarding foreign-parented multinational groups), please contact Taylor M. Kiessig of the Office of Associate Chief Counsel (International) at (202) 317-3800 (not a toll-free number). For further information regarding the remaining sections of this notice, please contact Mr. Aramburu at (202) 317-7006 or Mr. Yu at (202) 317-4718 (not toll-free numbers).

Section 45W Commercial Clean Vehicles and Incremental Cost for 2023

Notice 2023-9

SECTION 1. PURPOSE

This notice provides a safe harbor regarding the incremental cost of certain qualified commercial clean vehicles placed in service in calendar year 2023 for purposes of the new credit for qualified commercial clean vehicles under § 45W of the Internal Revenue Code (Code).¹

SECTION 2. BACKGROUND

Section 13403(a) of Public Law 117-169, 136 Stat. 1818 (August 16, 2022), commonly known as the Inflation Reduction Act of 2022, added new § 45W to the Code to allow a credit for qualified commercial clean vehicles (§ 45W credit), which is effective for vehicles acquired after December 31, 2022, and before January 1, 2033.

For purposes of § 38, § 45W(a) allows a taxpayer a § 45W credit for the purchase of each qualified commercial clean ve-

hicle, as defined in § 45W(c), placed in service by the taxpayer during the taxable year. The amount of the § 45W credit for each qualified commercial clean vehicle is the *lesser* of (1) 30 percent of the taxpayer's basis in the vehicle in the case of a vehicle not powered by a gasoline or diesel internal combustion engine (15 percent in any other case), or (2) the incremental cost of the vehicle. See § 45W(b)(1). Under § 45W(b)(4), the maximum credit allowed is \$7,500 in the case of a qualified commercial clean vehicle that has a gross vehicle weight rating of less than 14,000 pounds, and \$40,000 for all other vehicles.

Section 45W(b)(2) provides that the incremental cost of a qualified commercial clean vehicle is the excess of the purchase price of such vehicle over the price of a comparable vehicle. A comparable vehicle with respect to any qualified commercial clean vehicle is any vehicle that is powered solely by a gasoline or diesel internal combustion engine and is comparable in size and use to such qualified commercial clean vehicle. See § 45W(b)(3).

A qualified commercial clean vehicle under § 45W(c) includes (1) a vehicle that is treated as a motor vehicle for purposes of title II of the Clean Air Act and is manufactured primarily for use on public streets, roads, and highways, not including a vehicle operated exclusively on a rail or rails (street vehicle) and (2) mobile machinery as defined in § 4053(8).

The Department of the Treasury (Treasury Department) has reviewed an incremental cost analysis of current costs by the Department of Energy (DOE) across classes of street vehicles (DOE Analysis).² The DOE Analysis modeled the costs of representative commercial clean vehicles and comparable internal combustion engine vehicles. Results of the DOE Analysis show that the modeled incremental cost of all street vehicles, other than compact car PHEVs,³ that have a gross vehicle weight rating of less than 14,000 pounds will be greater than \$7,500 in calendar year 2023.

SECTION 3. SAFE HARBOR

The DOE Analysis calculated the incremental cost for compact car PHEVs, which include minicompact and subcompact cars, to be less than \$7,500. The Treasury Department and the Internal Revenue Service (IRS) will accept a taxpayer's use of the incremental cost published in the DOE Analysis to calculate the § 45W credit amount for compact car PHEVs placed in service during calendar year 2023.

In addition, the DOE Analysis provides an incremental cost analysis of current costs for several representative classes of street vehicles with a gross vehicle weight rating of 14,000 pounds or more in calendar year 2023. The Treasury Department and the IRS will accept a taxpayer's use of the incremental cost published in the DOE Analysis for the appropriate class of street vehicle to calculate the § 45W credit amount for vehicles placed in service during calendar year 2023.

For all street vehicles (other than compact car PHEVs) with a gross vehicle weight rating of less than 14,000 pounds, the DOE Analysis provides that incremental cost will not limit the available § 45W credit amount for vehicles placed in service in calendar year 2023. Accordingly, the Treasury Department and IRS will accept a taxpayer's use of \$7,500 as the incremental cost for all street vehicles (other than compact car PHEVs) with a gross vehicle weight rating of less than 14,000 pounds to calculate the § 45W credit amount for vehicles placed in service during calendar year 2023.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is the Office of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in its development. For further informa-

¹ Unless otherwise specified, all "section" or "§" references are to sections of the Code.

² www.energy.gov/node/4825009/

³ Compact cars are defined as those with an interior volume index of less than 110 cubic feet, and for the purpose of the DOE analysis also include minicompact cars, subcompact cars, and compact cars as described in 40 CFR 600.315-08(a)(1)(ii), (iii), and (iv). PHEVs are defined as commercial clean vehicles that use a gasoline or diesel internal combustion engine and are propelled to a significant extent by an electric motor that draws electricity from a battery that has a capacity of not less than 7 kilowatt hours (15 kilowatt hours in the case of a vehicle with a gross vehicle weight rating of 14,000 pounds or more) and are capable of being recharged from an external source of electricity. See § 45W(b)(1) and (c).

tion regarding this notice contact Chief Counsel on (202) 317-5254 (not a toll-free number).

Revised Timeline Regarding Implementation of Amended Section 6050W(e)

Notice 2023-10

SECTION 1. PURPOSE

This notice announces that calendar year 2022 will be regarded as a transition period for purposes of Internal Revenue Service (IRS) enforcement and administration with respect to the implementation of the amendments made to the de minimis exception for third party settlement organizations (TPSO) under section 6050W(e) of the Internal Revenue Code (Code) by the American Rescue Plan Act of 2021 (ARP), Pub. L. 117-2, 135 Stat. 4 (March 11, 2021), for returns for calendar years beginning after December 31, 2021.¹ The transition period described in this notice is intended to facilitate an orderly transition for TPSO compliance with section 6050W and participating payee compliance with income tax reporting.

SECTION 2. BACKGROUND

.01 Section 6050W

Section 6050W, added to the Code by § 3091 of the Housing Assistance Tax Act of 2008, Div. C of Pub. L. 110-289, 122 Stat. 2654, 2908, requires payment settlement entities to file an information return for each calendar year with respect to payments made in settlement of certain reportable payment transactions. Under § 6050W(a), the annual information return must set forth (1) the name, address, and taxpayer identification number (TIN) of the participating payee to whom payments were made and (2) the gross amount of the reportable payment transactions with respect to that payee.

Section 1.6050W-1(a)(6) defines “gross amount” to mean the total dollar amount of the aggregate reportable payment transactions for each participating payee, without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts, or any other amounts. Taxpayers required to make returns under section 6050W do so by filing Form 1099-K, Payment Card and Third Party Network Transactions. Returns must be furnished to the participating payees on or before January 31st of the year following the calendar year for which the return was made and must be filed with the IRS on or before February 28th (March 31st if filing electronically) of the year following the calendar year for which the return was made. *See* § 6050W(f); § 1.6050W-1(g).

Section 6050W covers two types of reportable payment transactions: (1) payment card transactions and (2) third party network transactions. *See* § 6050W(c). A payment settlement entity in the payment card context is a merchant acquiring entity; in the third party network context, it is a TPSO. § 6050W(b)(1).

A TPSO is the central organization that has the contractual obligation to make payment to the participating payees of third party network transactions. Section 6050W(b)(3). A third party network transaction is any transaction that is settled through a third party payment network. Section 6050W(c)(3). A central organization has a reporting obligation as a TPSO if it provides a third party payment network that allows purchasers to transfer funds to providers of goods and services. Section 1.6050W-1(c)(2).

A third party payment network is any agreement or arrangement that (i) involves the establishment of accounts with a central organization by a substantial number of providers of goods or services who are unrelated to the central organization and who have agreed to settle transactions for the provision of goods and services with purchasers according to the terms of agreements; (ii) provides standards and mechanisms for settling such transactions; and (iii) guarantees payments to the pro-

viders of goods and services in settlement of transactions with the purchasers. Section 6050W(d)(3).

A participating payee, in the case of a third party network transaction, is any person who accepts payment from a TPSO in settlement of such transaction. Section 6050W(d)(1)(A)(ii).

As originally enacted, section 6050W(e) provided that a TPSO is not required to report third party network transactions with respect to a participating payee unless the gross amount that would otherwise be reported exceeds \$20,000 and the number of such transactions with that participating payee exceeds 200.

02. Section 3406

Section 3406(a) requires certain payers to perform backup withholding by deducting and withholding income tax from a reportable payment when, among other circumstances, the payee fails to furnish his TIN to the payer or the IRS has notified the payer that the TIN furnished by the payee is incorrect. A reportable payment includes payments made by a TPSO that are required to be shown on a return under § 6050W. Section 3406(b)(3)(F). A payer is required to report the amount of deducted and withheld Federal income tax amounts on the information return filed with the IRS and furnished to the payee. In the case of the Form 1099-K, withheld income tax is reported in box 4. The payee may then claim credit for the amount of income tax withheld on the payee’s Federal income tax return.

.03 Sections 6721 and 6722

Section 6721 imposes a penalty for any failure to file an information return on or before the required filing date, and for any failure to include all of the information required to be shown on the return or the inclusion of incorrect information.

Section 6722 imposes a penalty for failure to furnish a payee statement on or before the required furnishing date to the person to whom such statement is required to be furnished, and for any failure to include all of the information required to be shown on a payee statement or the inclusion of incorrect information.

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

.04 American Rescue Plan Act of 2021
Section 9674(a) of the ARP amended section 6050W(e) to provide that, for returns for calendar years beginning after December 31, 2021, a TPSO is required to report payments in settlement of third party network transactions with respect to any participating payee that exceed a minimum threshold of \$600 in aggregate payments, regardless of the aggregate number of such transactions.

SECTION 3. TRANSITION PERIOD FOR ENFORCEMENT AND ADMINISTRATION OF COMPLIANCE

Calendar year 2022 will be regarded as a transition period for purposes of IRS enforcement and administration of the modified de minimis exception for TPSOs and third party network transactions as provided in this section. With respect to returns for calendar years beginning before January 1, 2023, a TPSO is not required to report payments in settlement of third party network transactions with respect to a participating payee unless the gross amount of aggregate payments to be reported exceeds \$20,000 and the number of such transactions with that participating payee exceeds 200. The IRS will not assert penalties under § 6721 or § 6722 for TPSOs failing to file or failing to furnish Forms 1099-K unless the gross amount of aggregate payments to be reported exceeds \$20,000 and the number of transactions exceeds 200. For returns for calendar years beginning after December 31, 2022, a TPSO is required to report payments in settlement of third party network transactions with any participating payee that exceed a minimum threshold of \$600 in aggregate payments, regardless of the number of such transactions.

The IRS will not regard calendar year 2022 as a transition period with respect to the requirements of section 6050W that were not modified by § 9674(a) of the ARP. In addition, those payers that have performed backup withholding under § 3406(a) during calendar year 2022 must file a Form 1099-K with the IRS and furnish a copy to the payee if total payments to and withholding from the payee exceeded \$600 for the calendar year.

SECTION 4. EFFECTIVE DATE

This notice is effective for returns for calendar years beginning before January 1, 2023.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is the Office of Associate Chief Counsel (Procedure and Administration).

Foreign Financial Institution Temporary U.S. Taxpayer Identification Number Relief

Notice 2023-11

SECTION 1. PURPOSE

This notice provides temporary relief procedures for certain foreign financial institutions (FFIs) required to report U.S. taxpayer identification numbers (U.S. TINs) for certain preexisting accounts as defined in an applicable Model 1 inter-governmental agreement (IGA). If an FFI in an eligible Model 1 IGA jurisdiction (as further defined in section 3.05 of this notice) complies with the procedures described in this notice, then the U.S. Competent Authority will not determine there is significant non-compliance (described in Article 5(2) or 5(3) of the relevant IGA) with the reporting Model 1 FFI's obligations under the IGA solely as a result of its failure to report U.S. TINs associated with its preexisting accounts.

The relief described in this notice is intended to enable the Internal Revenue Service (IRS) to collect and analyze additional information for accounts without U.S. TINs. To obtain the relief provided by this notice, the reporting Model 1 FFI must, as part of its requirements under this notice, use certain codes provided by the IRS that identify features of these accounts that may explain why the reporting Model 1 FFI does not report a U.S. TIN. The Department of the Treasury (Treasury Department) and the IRS intend to

use this data to enhance IRS compliance procedures and to inform potential future options for reporting Model 1 FFIs who continue to be unable to obtain and report the U.S. TIN for certain accounts. If permanent relief is granted in the future, it is anticipated that the scope of the accounts for which an FFI may obtain such relief will be narrower than the scope of accounts for which relief is given under this notice.

SECTION 2. BACKGROUND

On March 18, 2010, the Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147, 124 Stat. 71 (2010) (HIRE Act), added chapter 4 of Subtitle A (chapter 4), comprising sections 1471 through 1474, to the Internal Revenue Code (Code). Chapter 4 (commonly known as the Foreign Account Tax Compliance Act, or FATCA) addresses non-compliance by U.S. taxpayers holding foreign financial accounts or assets. FATCA requires certain FFIs to report to the IRS information about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold certain ownership interests. FATCA generally requires withholding agents to withhold 30 percent tax on certain U.S. source payments to FFIs that do not agree to report information to the IRS about their U.S. accounts. FATCA was enacted to ensure compliance with U.S. taxpayers' tax obligations.

In order to facilitate the exchange of information on financial accounts held by U.S. taxpayers, the Treasury Department collaborated with foreign governments to develop two alternative model IGAs (Model 1 IGAs and Model 2 IGAs) that are intended to provide an effective and efficient means for complying with FATCA while reducing the burden FATCA compliance imposes on financial institutions. The Model 1 IGA provides that a reporting Model 1 FFI will report certain information on U.S. reportable accounts maintained by the FFI to the Model 1 IGA jurisdiction tax authority, which will automatically exchange such information with the U.S. Competent Authority.

Each Model 1 IGA provides that a reporting Model 1 FFI shall be treated as complying with, and not subject to with-

holding under, section 1471 of the Code if the Model 1 IGA jurisdiction complies with its obligations under the IGA with respect to the FFI and the FFI complies with its reporting and registration obligations in accordance with the IGA. Under Model 1 IGAs, a reporting Model 1 FFI that does not satisfy those obligations shall not be subject to withholding under section 1471 of the Code unless the FFI is treated by the IRS as a nonparticipating financial institution under the procedures described below. Each Model 1 IGA also provides that the United States shall not require a reporting Model 1 FFI to withhold tax under section 1471 or 1472 of the Code with respect to an account held by a recalcitrant account holder or to close such account if the U.S. Competent Authority receives certain information specified in the Model 1 IGA with respect to such account.

The information required to be reported by a reporting Model 1 FFI includes the U.S. TIN of each specified U.S. person that is an account holder and, in the case of a non-U.S. entity with one or more specified U.S. persons who are controlling persons, the U.S. TIN of each controlling person for its U.S. reportable accounts (required U.S. TINs). The U.S. TIN of a U.S. citizen is the individual's U.S. Social Security number (SSN). Notwithstanding this reporting requirement, before 2017, a reporting Model 1 FFI was not required to report a required U.S. TIN for an account maintained as of the determination date specified in the applicable Model 1 IGA (preexisting account) that is a U.S. reportable account if the U.S. TIN was not in the reporting Model 1 FFI's records. In such cases, a reporting Model 1 FFI was required to report the date of birth of the relevant person, but only if the date of birth was in the reporting Model 1 FFI's records. Model 1 IGA jurisdictions committed to establish rules for 2017 and subsequent years requiring reporting Model 1 FFIs to obtain and report the required U.S. TINs for such accounts.

Each Model 1 IGA requires that the Model 1 IGA jurisdiction obtain and exchange the information specified in the Model 1 IGA (including each required U.S. TIN) with respect to each U.S. reportable account. The suspension of withholding under sections 1471 and 1472 of the Code pursuant to each Model 1 IGA

is conditioned on adequate reporting and exchange of information. If a reporting Model 1 FFI fails to report required U.S. TINs, the U.S. Competent Authority may notify the Model 1 IGA jurisdiction competent authority that there is significant non-compliance with respect to the reporting Model 1 FFI, in accordance with the Model 1 IGA. During the 18 months following the notification, the U.S. Competent Authority would work with the Model 1 IGA jurisdiction competent authority to address the non-compliance. If the reporting Model 1 FFI remains non-compliant for 18 months after the notification, under the relevant Model 1 IGA, the United States may treat the reporting Model 1 FFI as a nonparticipating financial institution that is subject to withholding under section 1471 of the Code.

On September 25, 2017, the Treasury Department and the IRS released Notice 2017-46, 2017-41 I.R.B. 275, which provided relief and guidance for reporting Model 1 FFIs that were unable to obtain and report required U.S. TINs for preexisting accounts. If a reporting Model 1 FFI complied with the conditions in Notice 2017-46, the U.S. Competent Authority would not determine that there had been significant non-compliance with the obligations under an applicable Model 1 IGA solely because of a reporting Model 1 FFI's failure to obtain and report each required U.S. TIN for a preexisting account. In order to qualify for the relief in Notice 2017-46, a reporting Model 1 FFI was required to: (1) obtain and report the date of birth of each account holder, and of each controlling person, whose U.S. TIN is not reported; (2) request annually from each account holder any missing required U.S. TIN; and (3) before reporting information that relates to calendar year 2017 to the Model 1 IGA jurisdiction, search electronically searchable data maintained by the reporting Model 1 FFI for any missing required U.S. TINs. The relief in Notice 2017-46 was limited to reporting for calendar years 2017, 2018, and 2019, and was intended to provide reporting Model 1 FFIs additional time to implement practices and procedures to obtain and report required U.S. TINs.

Pursuant to the Model 1 IGAs and Notice 2017-46, reporting Model 1 FFIs had up to six years to obtain required U.S.

TINs and could report information on such accounts without the U.S. TINs without being treated as in significant non-compliance with the obligations under an applicable Model 1 IGA. Consequently, U.S. citizens who reside abroad also had up to six years to obtain (if necessary) and provide an SSN or renounce their U.S. citizenship before facing consequences from their financial institutions (if any).

In addition, in 2019, the IRS issued relief procedures for certain persons who have relinquished, or intend to relinquish, their U.S. citizenship in order to ease the tax obligations that are part of the U.S. expatriation process. The procedures are available to U.S. citizens with a net worth of less than \$2 million and an aggregate tax liability of \$25,000 or less for the taxable year of expatriation and the five prior years. An applicant for the relief is not required to obtain an SSN for purposes of using the procedures and may use his or her best efforts in computing his or her total tax for each year. The relief procedures are available at <https://www.irs.gov/individuals/international-taxpayers/relief-procedures-for-certain-former-citizens>.

Notwithstanding the years of relief the Treasury Department and the IRS have provided to reporting Model 1 FFIs that have not been reporting required U.S. TINs for preexisting accounts, the IRS continues to receive reporting from Model 1 IGA jurisdictions that does not include required U.S. TINs for all preexisting accounts that are U.S. reportable accounts. Obtaining U.S. TINs from U.S. taxpayers connected to accounts at FFIs, including accounts located in the taxpayer's country of residence, is crucial to ensuring that the IRS has the necessary information to determine whether U.S. taxpayers are complying with their U.S. tax obligations. To better understand the issues that FFIs were facing in obtaining required U.S. TINs, the IRS developed a series of codes (TIN Codes) a reporting Model 1 FFI could use to populate the TIN field for 2020 data. The IRS shared the TIN Codes with each Model 1 IGA jurisdiction in early 2021 and then issued the TIN Codes in an FAQ on IRS.gov on May 13, 2021, available at <https://www.irs.gov/businesses/corporations/frequently-asked-questions-faqs-fatca-compliance-legal>. These TIN Codes indicated that a required U.S. TIN had not

been obtained in specified scenarios. The use of TIN Codes was not mandatory and did not affect the obligations of a reporting Model 1 FFI to collect and report required U.S. TINs.

The Treasury Department and the IRS have received communications from Model 1 IGA jurisdictions, FFIs, and U.S. citizens expressing concern that FFIs are closing or may close bank accounts of U.S. citizens who have failed to provide a required U.S. TIN, including accounts of U.S. citizens resident outside the United States. FFIs have indicated that these closures are based on concerns about being treated as in significant non-compliance with their obligations under a Model 1 IGA. Model 1 IGA jurisdictions have also indicated that FFIs are unable to close certain accounts, which may increase the risk that the FFI is found to be in significant non-compliance with its obligations.

The Treasury Department and the IRS also have received communications expressing concern that some FFIs are refusing to provide accounts to U.S. citizens resident in the FFI's jurisdiction, or otherwise providing access to accounts on less favorable terms than apply to other account holders, even if the U.S. citizen provides a U.S. TIN.

The Treasury Department and the IRS have determined that merely providing additional time for reporting Model 1 FFIs to implement practices and procedures to obtain and report required U.S. TINs for preexisting accounts will not address the concerns described above. Section 3 of this notice sets forth interim measures intended to address the concerns of FFIs and Model 1 IGA jurisdictions while providing the IRS additional information to enhance compliance procedures and addressing other concerns described above.

SECTION 3. U.S. TIN REPORTING BY REPORTING MODEL 1 FFIS

.01 In general

In order for the Treasury Department and the IRS to determine an appropriate permanent solution to the concerns expressed above, the IRS needs to collect additional information from reporting

Model 1 FFIs explaining why they have not provided all required U.S. TINs. Accordingly, as an interim measure, sections 3.02, 3.03 and 3.04 of this notice provide that reporting Model 1 FFIs that follow specified procedures will not be treated as in significant non-compliance with their obligations under an applicable Model 1 IGA solely because of the failure to report a required U.S. TIN with respect to a pre-existing account. Section 3.05 of this notice limits this relief to reporting Model 1 FFIs that are in a Model 1 IGA jurisdiction that makes good faith efforts to increase the likelihood that U.S. citizens residing in that jurisdiction will report their U.S. TINs to the FFIs and that takes other steps specified in section 3.05.

.02 Relief for reporting on certain pre-existing accounts that are U.S. reportable accounts

For reporting on calendar years 2022 (due by September 30, 2023), 2023 (due by September 30, 2024), and 2024 (due by September 30, 2025), the U.S. Competent Authority will not determine that there is significant non-compliance with the obligations of a reporting Model 1 FFI under an applicable Model 1 IGA with respect to reporting required U.S. TINs for preexisting accounts solely because of a failure to obtain and report each required U.S. TIN for such accounts, provided that the reporting Model 1 FFI complies with the conditions set forth in sections 3.03 and 3.04 of this notice and is in a Model 1 IGA jurisdiction that satisfies the requirements of section 3.05 of this notice.

This relief is limited to reporting on preexisting accounts. It does not apply to U.S. reportable accounts opened after the determination date specified in the applicable Model 1 IGA (new accounts), including new accounts held by account holders of preexisting accounts.

Nothing in this notice prevents the U.S. Competent Authority from finding significant non-compliance for a failure to satisfy any obligation under the applicable Model 1 IGA other than a failure to obtain and report each required U.S. TIN for preexisting accounts. Furthermore, nothing in this notice affects a reporting Model 1 FFI's obligations under chapter 3 or chap-

ter 61 with respect to a reportable amount or reportable payment.

.03 Requirements for reporting Model 1 FFIs

A reporting Model 1 FFI is eligible for the relief described in section 3.02 of this notice only if, for each U.S. reportable account (including new accounts) with a missing required U.S. TIN, the reporting Model 1 FFI: (1) obtains and reports the date of birth of each account holder that is an individual and controlling person whose U.S. TIN is not reported; (2) starting in calendar year 2023, annually requests from each account holder any missing required U.S. TIN, as described in further detail in section 3.04 below; (3) starting in calendar year 2023, annually searches electronically searchable data maintained by the reporting Model 1 FFI for any missing required U.S. TINs; and (4) reports an accurate TIN Code for each account that is missing a required U.S. TIN. For reporting on calendar year 2022, the fourth condition may be satisfied by a reporting Model 1 FFI by using either the TIN Codes issued by the IRS in May 2021 or updated TIN Codes issued by the IRS in early 2023. For reporting on calendar years 2023 and 2024, the fourth condition must be satisfied by a reporting Model 1 FFI by using the most recent TIN Codes issued by the IRS.

.04 Annual request for missing required U.S. TINs

To satisfy the requirement to make an annual request from each account holder for missing required U.S. TINs, reporting Model 1 FFIs must use the method of communication that is, in the FFI's reasonable judgment, most likely to reach the account holder. In addition, the communication must include either of the following:

- the web address of the State Department's Joint FATCA FAQs (<https://travel.state.gov/content/travel/en/international-travel/while-abroad/Joint-Foreign-Account-Tax-Compliance-FATCA-FAQ.html>),¹ or
- (i) a copy of the FAQs described in the preceding bullet and (ii) either
 - a copy of the relief procedures provided by the IRS for certain former citizens, or

¹The Joint FATCA FAQs provide information on how to obtain an SSN, how to renounce U.S. citizenship, and relevant U.S. tax consequences (including a link to the IRS's relief procedures for certain former U.S. citizens).

- the web address for such procedures (<https://www.irs.gov/individuals/international-taxpayers/relief-procedures-for-certain-former-citizens>).

An FFI must retain records of the policies and procedures adopted to satisfy this requirement and documentation that those policies and procedures were followed to establish its compliance with the requirements of this section 3.04 until the end of calendar year 2028.

.05 Eligible Model 1 IGA jurisdictions

For a reporting Model 1 FFI to be eligible for the relief described in this section with respect to reporting for a particular calendar year or other appropriate reporting period, the applicable Model 1 IGA jurisdiction must make good faith efforts, by the date that is nine months after the end of the calendar year to which the information relates, to do the following:

(1) Encourage U.S. citizens resident in the jurisdiction to provide U.S. TINs to FFIs when requested;

(2) Take measures to enforce compliance by reporting Model 1 FFIs identified by the U.S. Competent Authority to the Model 1 IGA jurisdiction as potentially non-compliant;

(3) Encourage FFIs located in a Model 1 IGA jurisdiction to not discriminate against U.S. citizens that do provide a U.S. TIN; and

(4) If notified by the U.S. Competent Authority, take steps to conclude Competent Authority Arrangements with the U.S. Competent Authority, to implement an IGA, amend an Annex II to an IGA, or exchange country-by-country information.

In order to provide a transition period for the satisfaction of these conditions, section 3.05 will be deemed to have been satisfied for reporting on calendar year 2022.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Sarah Stein of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Sarah Stein at (202) 317-4917 (not a toll-free number).

Administrative, Procedural, and Miscellaneous
26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also, Part 1, §§ 174, 446, 1.446-1.)

Rev. Proc. 2023-8

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 2022-14, 2022-7 I.R.B. 502, to provide procedures under § 446 of the Internal Revenue Code (Code) and § 1.446-1(e) of the Income Tax Regulations to obtain automatic consent of the Commissioner of Internal Revenue (Commissioner) to change methods of accounting for specified research or experimental expenditures to comply with § 174 of the Code, as amended by § 13206 of Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). References in this revenue procedure to “former § 174” refer to § 174 as in effect for research or experimental expenditures paid or incurred in taxable years beginning before the effective date of the amendments made to § 174 by § 13206(a) of the TCJA, and all following references to “§ 174” in this revenue procedure refer to § 174 as amended by the TCJA.

SECTION 2. BACKGROUND

.01 Former § 174.

(1) Former § 174(a)(1) provided that a taxpayer may treat research or experimental expenditures which are paid or incurred by the taxpayer during the taxable year in connection with the taxpayer’s trade or business as expenses which are not chargeable to capital account. The expenditures so treated were allowed as a deduction. Under former § 174(a)(2)(A), a taxpayer could, without the consent of the Secretary of the Treasury or her delegate (Secretary), adopt the method provided in former § 174(a) for the taxpayer’s first taxable year for which expenditures described in former § 174(a)(1) were paid or incurred. Under former § 174(a)(2)(B), a taxpayer could, with the consent of the Secretary, adopt at any time the method provided in former § 174(a).

(2) Under former § 174(b)(1), at the election of the taxpayer, made in accordance with regulations prescribed by the Secretary, research or experimental expenditures could be treated as deferred expenses if such expenditures were: 1) paid or incurred by the taxpayer in connection with the taxpayer’s trade or business, 2) not treated as expenses under former § 174(a), and 3) chargeable to capital account but not chargeable to property of a character which is subject to the allowance under § 167 of the Code (relating to allowance for depreciation, etc.) or § 611 of the Code (relating to allowance for depletion).

(3) Former § 174(b)(1) provided that in computing taxable income, such deferred expenses were allowed as a deduction ratably over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures). Such deferred expenses were expenditures properly chargeable to capital account for purposes of § 1016(a)(1) of the Code (relating to adjustments to basis of property).

(4) Under former § 174(b)(2), the election provided by former § 174(b)(1) could be made for any taxable year, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The method so elected, and the period selected by the taxpayer, were required to be adhered to in computing taxable income for the taxable year for which the election was made and for all subsequent taxable years unless, with the approval of the Secretary, a change to a different method (or to a different period) was authorized with respect to part or all of such expenditures. The election did not apply to any expenditure paid or incurred during any taxable year before the taxable year for which the taxpayer made the election.

(5) Under § 1.174-1, which applies to research or experimental expenditures paid or incurred in taxable years beginning before December 31, 2021 (the effective date of the amendments to § 174 under § 13206 of the TCJA), research or experimental expenditures which are neither treated as expenses nor deferred and

amortized under § 174 must be charged to capital account.¹

.02 TCJA amendments.

(1) As amended by § 13206(a) of the TCJA, § 174(a)(1) provides that in the case of a taxpayer's specified research or experimental expenditures for any taxable year, except as provided in § 174(a)(2), no deduction is allowed for such expenditures. Section 174(a)(2) provides that the taxpayer must charge such expenditures to capital account² and is allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research within the meaning of § 41(d)(4)(F) of the Code) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. The method of accounting described in this section 2.02(1) is referred to as the "required § 174 method" in this revenue procedure.

(2) Under § 174(b) the term "specified research or experimental expenditures" means, with respect to any taxable year, research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

(3) Section 174(c)(1) provides that the required § 174 method does not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under § 167 (relating to allowance of depreciation, etc.) or § 611 (relating to allowance for depletion); but for purposes of § 174, allowances under § 167 and allowances under § 611 are considered as expenditures.

(4) Section 174(c)(2) provides that the required § 174 method does not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(5) Section 174(c)(3) provides that for purposes of § 174, any amount paid or incurred in connection with the development

of any software is treated as a research or experimental expenditure accounted for under the required § 174 method.

(6) Under § 174(d), if any property with respect to which specified research or experimental expenditures are paid or incurred is disposed, retired, or abandoned during the period which such expenditures are allowed as an amortization deduction under the required § 174 method, no deduction is allowed with respect to such expenditures on account of such disposition, retirement, or abandonment and such amortization deduction will continue with respect to such expenditures.

(7) Section 13206(b) of the TCJA provides that the amendments made by § 13206(a) of the TCJA to former § 174 "shall be treated as a change in method of accounting for purposes of section 481" and that "(1) such change shall be treated as initiated by the taxpayer, (2) such change shall be treated as made with the consent of the Secretary, and (3) such change shall be applied only on a cut-off basis for any research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made."

(8) Section 13206(e) of the TCJA provides that the amendments made by § 13206(a) of the TCJA to former § 174 apply to research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

.03 Section 446(e).

(1) Except as otherwise expressly provided in the Code and the regulations thereunder, §§ 446(e) and 1.446-1(e)(2) require a taxpayer to secure the consent of the Commissioner before changing a method of accounting for Federal income tax purposes. Section 1.446-1(e)(3) (i) states, in part, that except as otherwise provided under the authority of § 1.446-1(e)(3)(ii), to secure the Commissioner's consent to a taxpayer's change in method of accounting the taxpayer generally must file an application on Form 3115, *Application for Change in Accounting Method*, with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting.

Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures under which taxpayers will be permitted to change their method of accounting. The administrative procedures will prescribe those terms and conditions necessary to obtain the Commissioner's consent to effect the change and to prevent amounts from being duplicated or omitted.

(2) Rev. Proc. 2015-13, 2015-5 I.R.B. 419, as clarified and modified by Rev. Proc. 2015-33, 2015-24 I.R.B. 1067, and as modified by Rev. Proc. 2017-59, 2017-48 I.R.B. 543, and Rev. Proc. 2021-34, 2021-35 I.R.B. 337, and as updated by Rev. Proc. 2021-26, 2021-22 I.R.B. 1163, sets forth the general procedures by which a taxpayer may obtain the automatic consent of the Commissioner to change a method of accounting described in the *List of Automatic Changes*. Rev. Proc. 2022-14 contains the current *List of Automatic Changes*.

(3) A change in a taxpayer's treatment of specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, to comply with § 174 is a change in method of accounting to which §§ 446(e) and 481, and the corresponding regulations, apply. A taxpayer changing the treatment of specified research or experimental expenditures paid or incurred to the method of accounting that complies with § 174 must use the accounting method change procedures in Rev. Proc. 2015-13, or its successor. Section 3 of this revenue procedure modifies Rev. Proc. 2022-14 to allow taxpayers to obtain automatic consent to change their method of accounting to comply with § 174 for taxable years beginning after December 31, 2021.

(4) As discussed in section 2.02(7) of this revenue procedure, § 13206(b) of the TCJA provides that the amendments made by § 13206(a) of the TCJA to former § 174 are treated as a change in method of accounting for purposes of § 481 that is initiated by the taxpayer and made with the consent of the Commissioner, and that "such change shall be applied only on a cut-off basis for any research or experimental expenditures

¹The term "capital account" in § 1.174-1 includes capital asset accounts, including, but not limited to, inventory and depreciable property.

²The term "capital account" in § 174(a)(2) does not mean the capital account described in § 1.174-1. The term means a separate specified research or experimental capital account.

paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made.” Pursuant to section 2.07 of Rev. Proc. 2015-13, when a change in method of accounting is made without a § 481(a) adjustment (for example, on a cut-off basis), in general, only the items arising on or after the beginning of the year of change, or other operative date, are accounted for under the method of accounting for which consent is granted. Any items arising before the year of change, or other operative date, continue to be accounted for under the taxpayer’s former method of accounting. When a change in method of accounting is made on a cut-off basis, no amounts are duplicated or omitted, and therefore, a § 481(a) adjustment is not necessary or permitted.

(5) In accordance with § 13206(b) of the TCJA, a change in a taxpayer’s method of accounting to the required § 174 method for the first taxable year that the amendments made by § 13206(a) of the TCJA are effective must be made only on a cut-off basis. The required § 174 method applies only to specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021. The procedures in section 3 of this revenue procedure provide an automatic change in method of accounting to the required § 174 method to comply with § 174 by filing a statement with the taxpayer’s original Federal income tax return for the first taxable year in which § 174 becomes effective in lieu of a Form 3115. If a change to the required § 174 method to comply with § 174 for some or all of the taxpayer’s specified research or experimental expenditures is made for a taxable year subsequent to the taxable year of the taxpayer in which § 174 becomes effective, the change to the required § 174 method to comply with § 174 is made by filing a Form 3115, with a modified § 481(a) adjustment that takes into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

(6) Additionally, section 3 of this revenue procedure provides a transition rule for taxpayers who filed a Federal tax return on or before this revenue procedure is published in the Internal Revenue Bulletin

for a taxable year beginning after December 31, 2021. The transition rule provides that such taxpayer is deemed to have complied with the § 446 method change procedures and section 7.02 of Rev. Proc. 2022-14, as modified by section 3 of this revenue procedure, if the taxpayer properly reported the amount of specified research or experimental expenditures on Part VI of Form 4562, *Depreciation and Amortization*, filed with the Federal tax return, and properly capitalized and amortized such specified research or experimental expenditures in accordance with the required § 174 method.

(7) A taxpayer that changes its method of accounting for specified research or experimental expenditures under section 7.02 of Rev. Proc. 2022-14, as modified by section 3 of this revenue procedure, will receive limited audit protection under section 8.01 of Rev. Proc. 2015-13. Specifically, audit protection will not apply for expenditures paid or incurred in taxable years beginning before January 1, 2022. Additionally, notwithstanding the audit protection rules under section 8.01 of Rev. Proc. 2015-13, the IRS may change the characterization or classification of expenditures as specified research or experimental expenditures as defined in § 174(b) in order to apply § 174 as well as the change under section 7.02 of Rev. Proc. 2022-14, as modified by section 3 of this revenue procedure, to the proper amount of expenditures paid or incurred in each taxable year beginning after December 31, 2021.

SECTION 3. AUTOMATIC METHOD CHANGE TO REQUIRED § 174 METHOD

.01 *Modification of Section 7 of Rev. Proc. 2022-14.* Section 7 of Rev. Proc. 2022-14 is modified to add new section 7.02 to read as follows.

.02 *Specified Research or Experimental Expenditures.*

(1) *Description of change.*

(a) This change applies to a taxpayer that changes its method of accounting for specified research or experimental expenditures (as defined under § 174(b)) to the required § 174 method (as defined in section 7.02(1)(b) of this revenue procedure) to comply with § 174. Unless otherwise

stated, references to “§ 174” in this section 7.02 refer to § 174 as amended by § 13206(a) of the TCJA. Section 13206(e) of the TCJA provides that the amendments made by § 13206 of the TCJA apply to amounts paid or incurred in taxable years beginning after December 31, 2021.

(b) Section 174(a)(1) provides that in the case of a taxpayer’s specified research or experimental expenditures for any taxable year, except as provided in § 174(a)(2), no deduction is allowed for such expenditures. Section 174(a)(2) provides that the taxpayer must charge such expenditures to capital account and is allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research within the meaning of § 41(d)(4)(f) of the Code) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. The method of accounting described in this section 7.02(1)(b) is referred to as the “required § 174 method” in this section 7.02.

(2) *Applicability.* This change to the required § 174 method applies to specified research or experimental expenditures (as defined in § 174(b)) paid or incurred in taxable years beginning after December 31, 2021.

(3) *Inapplicability.* This change does not apply to:

(a) a change in the treatment of acquired, leased, or licensed computer software under Rev. Proc. 2000-50, 2000-52 I.R.B. 601, as modified by Rev. Proc. 2007-16, 2007-1 C.B. 358 (see section 9.01 of this revenue procedure); or

(b) a change in the treatment of research or experimental expenditures under former § 174, or software development expenditures, paid or incurred in taxable years beginning before January 1, 2022 (see sections 7.01 and 9.01 of this revenue procedure).

(4) *Manner of making change.*

(a) *First taxable year beginning after December 31, 2021.*

(i) *Cut-off basis.* The change under section 7.02 of this revenue procedure for specified research or experimental expenditures paid or incurred in the first taxable year beginning after December 31, 2021, is implemented on a cut-off basis.

(ii) *Statement in lieu of a Form 3115 for first taxable year beginning after December 31, 2021.* Except as otherwise provided in section 7.02(5) of this revenue procedure, the requirement of § 1.446-1(e)(3)(i) to file a Form 3115, *Application for Change in Accounting Method*, is waived and a statement in lieu of a Form 3115 is authorized for the change in method of accounting under section 7.02 of this revenue procedure for which the year of change is the first taxable year beginning after December 31, 2021. Notwithstanding the definition of Form 3115 in section 3.07 of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, the statement in lieu of a Form 3115 that is permitted under this section 7.02(4)(a)(ii) is considered a Form 3115 for purposes of the automatic consent procedures of Rev. Proc. 2015-13. The requirement to file the duplicate copy, under section 6.03(1)(a) of Rev. Proc. 2015-13, is waived. The statement must include the following information for each applicant:

(A) the name and employer identification number or social security number, as applicable, of the applicant that has paid or incurred specified research or experimental expenditures after December 31, 2021;

(B) the beginning and ending dates of the first taxable year in which the change to the required § 174 method takes effect for the applicant (year of change);

(C) the designated automatic accounting method change number for this change (see section 7.02(8) of this revenue procedure);

(D) a description of the type of expenditures included as specified research or experimental expenditures;

(E) the amount of specified research or experimental expenditures paid or incurred by the applicant during the year of change; and

(F) a declaration that the applicant is changing the method of accounting for specified research or experimental expenditures to capitalize such expenditures to a specified research or experimental capital account, and amortize such amount over either a 5-year period for domestic research or 15-year period for foreign research (as applicable) beginning with the mid-point of the taxable year in which such expenditures are paid or incurred in accordance with the method permitted un-

der § 174 for the year of change. Also, the declaration must state that the applicant is making the change on a cut-off basis.

(b) *Year of change later than the first taxable year beginning after December 31, 2021.*

(i) *Modified § 481(a) adjustment.* The change under section 7.02 of this revenue procedure for a year of change later than the first taxable year beginning after December 31, 2021, is made with a modified § 481(a) adjustment, and should take into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

(ii) *Form 3115.* In completing a Form 3115, *Application for Change in Accounting Method*, to make the change in method of accounting under section 7.02 of this revenue procedure with respect to any year of change later than the first taxable year beginning after December 31, 2021, a taxpayer must include on an attachment to Form 3115:

(A) a description of the type of expenditures included as specified research or experimental expenditures;

(B) the taxable year(s) in which the specified research or experimental expenditures subject to the change were paid or incurred by the applicant; and

(C) a declaration that the applicant is changing its method of accounting for specified research or experimental expenditures to capitalize such expenditures to a specified research or experimental capital account, and amortize such amount over either a 5-year period for domestic research or 15-year period for foreign research (as applicable) beginning with the mid-point of the taxable year in which such expenditures are paid or incurred in accordance with the method permitted under § 174 for the year of change. Also, the declaration must state that the applicant is making the change with a modified § 481(a) adjustment that takes into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

(5) *Transition rule.* A taxpayer who filed a Federal tax return on or before January 17, 2023, for a taxable year beginning after December 31, 2021, is deemed to have complied with the § 446 method

change procedures and section 7.02 of this revenue procedure to change its method of accounting for specified research or experimental expenditures paid or incurred in the first taxable year beginning after December 31, 2021, to the required § 174 method to comply with § 174 if the taxpayer:

(a) reported the amount of specified research or experimental expenditures paid or incurred for such taxable year on Part VI of Form 4562, *Depreciation and Amortization*, filed with the Federal tax return, and

(b) properly capitalized and amortized such specified research or experimental expenditures in accordance with the required § 174 method for such taxable year.

(6) *Certain eligibility rule temporarily inapplicable.* The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, does not apply to changes to the required § 174 method for the taxpayer's first taxable year beginning after December 31, 2021.

(7) *No audit protection for expenditures paid or incurred in taxable years prior to the first taxable year in which § 174 becomes effective.* A taxpayer does not receive audit protection under section 8.01 of Rev. Proc. 2015-13 for the change under section 7.02 of this revenue procedure with respect to expenditures paid or incurred in taxable years beginning on or before December 31, 2021. See section 8.02(2) of Rev. Proc. 2015-13.

(8) *Designated automatic accounting method change number.* The designated automatic accounting method change number for a change under section 7.02 of this revenue procedure is "265."

(9) *No inference relating to expenditures paid or incurred in taxable years prior to the first taxable year in which § 174 becomes effective.* No inference may be drawn from section 7.02 of this revenue procedure regarding the treatment of research or experimental expenditures paid or incurred in, and changes in methods of accounting for, taxable years in which former § 174 was in effect, including issues relating to the application of §§ 1.174-1, 1.174-3, and 1.174-4 of the Income Tax Regulations for taxable years in which former § 174 was in effect.

(10) *Contact information.* For further information regarding a change under this

section, contact Martha M. Garcia at (202) 317-6853 (not a toll-free number).

SECTION 4. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies section 7 of Rev. Proc. 2022-14.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, in which § 174 is in effect.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget under OMB control numbers 1545-0074 for individual filers and 1545-0123 for business filers, in accordance with the Paperwork Reduction Act (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 the collection of information displays a valid OMB control number. The collection of information in this revenue procedure is in section 3, which adds sections 7.02(4)(a)(ii) and 7.02(4)(b)(ii) to Rev. Proc. 2022-14. This information is necessary and will be used to determine whether the taxpayer properly changed to a permitted method of accounting. The collections of information are required for the taxpayer to obtain consent to change its method of accounting.

SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Martha M. Garcia and John M. Deininger of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Martha M. Garcia or John M. Deininger at (202) 317-6853 (not a toll-free number).

26 CFR 601.201: Rulings and determination letters. (Also: Part I, Sections 832, 846; 1.832-4, 1.846-1.)

Rev. Proc. 2023-10

SECTION 1. PURPOSE

This revenue procedure prescribes the loss payment patterns for the 2022 determination year and the discount factors for the 2022 accident year for use by insurance companies in computing discounted unpaid losses under § 846 of the Internal Revenue Code and discounted estimated salvage recoverable under § 832. This revenue procedure also provides, for convenience, discount factors for losses incurred in the 2022 accident year and earlier accident years for use in taxable years beginning in 2022. The discount factors for accident years before 2022 were prescribed in earlier revenue procedures. See, e.g., Rev. Proc. 2021-54, 2021-52 I.R.B. 903.

SECTION 2. BACKGROUND

.01 Section 846 provides that discounted unpaid losses must be separately determined for each accident year of each line of business by applying an interest rate determined under § 846(c) and the appropriate loss payment pattern to the amount of unpaid losses as measured at the end of the tax year.

.02 Section 846(c) provides for the use of an annual rate of interest determined on the basis of the corporate bond yield curve (as defined in § 430(h)(2)(D)(i), determined by substituting “60-month period” for “24-month period” therein). Section 1.846-1(c) of the Income Tax Regulations further provides that the annual rate for any calendar year is determined on the basis of a yield curve that reflects the average, for the most recent 60-month period ending before the beginning of the calendar year, of monthly yields on corporate bonds described in section 430(h)(2)(D)(i). The annual rate is the average of that yield curve’s monthly spot rates with times to maturity from four and one-half years to ten years.

.03 The applicable interest rate for 2022 under § 846(c) and § 1.846-1(c), is 2.67 percent, determined using semiannual compounding.

.04 Section 846(d) directs the Secretary to use the most recent aggregate loss payment data of property and casualty insurance companies to determine and publish a loss payment pattern for each line of business every five years. This payment pattern is used to discount unpaid losses for the accident year ending with a determination year and for each of the four succeeding accident years. See § 846(d)(1). Pursuant to § 1.846-1(d)(2), the Secretary may adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other published guidance if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one. The preamble to proposed regulations under § 846 (REG-103163-18) published in the Federal Register (83 FR 55646) on November 7, 2018 (Proposed Regulations) described a proposed methodology for adjusting the loss payment pattern for any line of business. Commenters on the Proposed Regulations expressed support for the smoothing adjustments described in the preamble to the Proposed Regulations, and § 1.846-1(d)(2) of the Proposed Regulations was adopted as proposed in final regulations under § 846 (T.D. 9863, 84 FR 27947) published on June 17, 2019.

.05 Pursuant to § 846(d) and § 1.846-1(d)(2), the Secretary has determined a loss payment pattern for each property and casualty line of business for the 2022 determination year that, pursuant to § 846(d)(1), must be applied through the 2026 accident year. The loss payment patterns for the 2022 determination year are based, initially, on the aggregate loss payment information reported on the 2020 annual statements of property and casualty insurance companies and compiled by A.M. Best and Co. The lines of business for the 2022 determination year are the same as the lines of business for the 2017 determination year. See Rev. Proc. 2019-31, 2019-33 I.R.B. 643, and Rev. Proc. 2019-06, 2019-02 I.R.B. 284, for background concerning the loss payment patterns and application of the discount factors. Losses are reported on the annual statement net of losses on reinsurance ceded but include losses on assumed proportional reinsurance. Losses with respect to assumed non-proportional reinsurance are

reported in three separate lines of business (for property, liability, and financial reinsurance). The loss data include defense, cost containment, adjusting, and other loss expenses, but are not reduced for salvage and subrogation receipts. For the 2022 determination year, only one line of business requires adjustments under § 1.846-1(d) (2). That line of business is Products Liability – Claims Made. The initial payment pattern for that line of business results in a negative payment amount for the fifth year after the accident year. Therefore, the payment amounts for the fourth through the sixth year after the accident year are adjusted following the steps listed in the preamble to the Proposed Regulations. See 83 FR 55646, 55651.

SECTION 3. SCOPE

This revenue procedure applies to any insurance company that is required to discount unpaid losses under § 846 for a line of business using the discount factors published by the Secretary. This revenue procedure also applies to any insurance company that is required to discount estimated salvage recoverable under § 832.

SECTION 4. DISCOUNT FACTORS FOR THE 2022 ACCIDENT YEAR

.01 The tables in this section 4 present separately for each line of business the discount factors for losses incurred in the 2022 accident year for use by insurance companies in computing discounted unpaid losses under § 846 and estimated salvage recoverable under § 832. The discount factors presented in this section are generally determined by using the applicable interest rate for 2022 under § 846(c) and § 1.846-1(c), which is 2.67 percent, determined using semiannual compounding. The exceptions are the discount factors for long-tail lines of business determined using the composite method described in section V of Notice 88-100, 1988-2 C.B. 439. These discount factors are to be used in taxable years beginning in 2032 for losses incurred in accident years not separately reported on the annual statement for 2032. For taxable years beginning after 2032, the discount factors to be used for losses incurred in the 2022 accident year will be those determined using the composite method for later ac-

cident years. These discount factors will be published in later years. All discount factors are determined by assuming all loss payments occur in the middle of the calendar year.

.02 Section V of Notice 88-100, 1988-2 C.B. 439, sets forth a composite method for computing discounted unpaid losses for accident years that are not separately reported on the annual statement. Tables 1 and 2 separately provide discount factors for insurance companies that have elected to use the composite method of Notice 88-100. See Rev. Proc. 2002-74, 2002-2 C.B. 980. The discount factors computed using the composite method are unrelated to the composite discount factors referred to in § 1.846-1(b)(1)(ii) and (4), which apply to lines of business for which the Secretary has not published discount factors. The composite discount factors for use with respect to such lines of business are labelled “Short-Tail Composite” (in Table 1, part B) and “Long-Tail Composite” (in Table 2, part B). The “Miscellaneous Casualty” discount factors referenced in § 1.846-1(b)(2) are not set forth in tables but are equivalent to the “Short-Tail Composite” discount factors.

Table 1 (part A)
Discount Factors Under Section 846 (percent)
For Losses Incurred in Accident Year 2022 in Short-Tail Lines of Business

Taxable Year Beginning in	Auto Physical Damage	Fidelity/Surety	Financial Guaranty/ Mortgage Guaranty	International	Other*
2022	98.5087	96.0741	95.6153	96.2003	97.2283
2023	97.3911	97.3911	97.3911	97.3911	97.3911
<i>Taxpayer Not Using Composite Method</i>					
Years after 2023	98.6826	98.6826	98.6826	98.6826	98.6826
<i>Taxpayer Using the Composite Method</i>					
2024	98.6826	98.6826	98.6826	98.6826	98.6826
Years after 2024	Use composite method discount factors published for the relevant accident year.**				

* For the Accident and Health line of business (other than disability income or credit disability insurance), the discount factor for taxable year 2022 is 98.6826 percent. This is also the discount factor used in later taxable years for taxpayers not using the composite method. For taxpayers using the composite method, the discount factor for losses incurred in 2022 is the discount factor published for Accident and Health lines of business for losses incurred in the accident year coinciding with the taxable year.

**The relevant accident year is the accident year that is two years prior to the specified taxable year.

Table 1 (part B)
Discount Factors Under Section 846 (percent)
For Losses Incurred in Accident Year 2022 in Short-Tail Lines of Business

Taxable Year Beginning in	Reinsurance - Nonproportional Assumed Financial Lines	Reinsurance - Nonproportional Assumed Liability	Reinsurance - Nonproportional Assumed Property	Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary & Theft)	Warranty	Short-Tail Composite
2022	96.1755	95.3149	96.5023	97.7793	98.5010	97.4381
2023	97.3911	97.3911	97.3911	97.3911	97.3911	97.3911
<i>Taxpayer Not Using Composite Method</i>						
Years after 2023	98.6826	98.6826	98.6826	98.6826	98.6826	98.6826
<i>Taxpayer Using the Composite Method</i>						
2024	98.6826	98.6826	98.6826	98.6826	98.6826	98.6826
Years after 2024	Use composite method discount factors published for the relevant accident year.**					
**The relevant accident year is the accident year that is two years prior to the specified taxable year.						

Table 2 (part A)
Discount Factors Under Section 846 (percent)
For Losses Incurred in Accident Year 2022 in Long-Tail Lines of Business

Taxable Year Beginning in	Commercial Auto/Truck Liability/Medical	Medical Professional Liability - Claims-Made	Medical Professional Liability - Occurrence	Multiple Peril Lines	Other Liability - Claims-Made	Other Liability - Occurrence
2022	94.5127	92.3146	87.8300	95.7799	92.0534	90.7411
2023	95.0679	93.3168	89.6041	94.3300	92.9253	91.5404
2024	95.5799	93.6166	90.9006	94.3613	92.9667	92.1947
2025	95.8620	94.4096	92.1748	94.3016	93.1601	92.5186
2026	95.7709	94.2538	92.9215	94.1052	93.1010	92.7994
2027	95.3403	94.8407	93.2830	94.3444	93.1449	91.8641
2028	95.3617	94.4493	93.6423	94.4224	92.8241	91.8523
2029	95.8006	95.2523	93.5226	96.0402	94.3791	92.5452
2030	96.6886	96.4696	95.1962	96.8042	96.6887	93.4680
2031	98.3919	97.8157	96.7412	98.1299	97.2308	95.1537
<i>Taxpayer Not Using Composite Method</i>						
2032	98.6826	98.6826	97.9293	98.6826	98.4739	96.3804
2033	98.6826	98.6826	98.6826	98.6826	98.6826	97.5988
Years after 2033	98.6826	98.6826	98.6826	98.6826	98.6826	98.6826
<i>Taxpayer Using the Composite Method</i>						
2032	98.6826	98.6826	97.9293	97.9691	98.5007	97.0865
Years after 2032	Use composite method discount factors published for the relevant accident year.**					
**The relevant accident year is the accident year that is ten years prior to the specified taxable year.						

Table 2 (part B)
Discount Factors Under Section 846 (percent)
For Losses Incurred in Accident Year 2022 in Long-Tail Lines of Business

Taxable Year Beginning in	Private Passenger Auto Liability/ Medical	Products Liability - Claims-Made	Products Liability - Occurrence	Workers' Compensation	Long-Tail Composite
2022	96.1701	89.9633	89.3630	89.7304	93.8901
2023	95.8589	91.1883	90.6396	88.3566	93.2372
2024	95.9333	91.4161	91.6708	87.8161	93.0141
2025	95.8576	90.5530	92.2079	87.3806	92.4240
2026	95.0320	91.9350	92.5125	87.6583	92.1521
2027	94.4641	93.4070	92.9497	87.1058	91.7300
2028	94.9895	95.0050	93.8016	87.6622	91.9589
2029	95.1268	95.4107	94.0743	89.0452	93.1631
2030	95.8190	96.5637	95.0202	90.3572	94.4061
2031	97.7990	98.0949	96.8704	91.2131	95.5892
<i>Taxpayer Not Using Composite Method</i>					
2032	98.6826	98.6826	98.0610	92.3944	96.8119
2033	98.6826	98.6826	98.6826	93.5960	98.0004
2034	98.6826	98.6826	98.6826	94.8180	98.6826
2035	98.6826	98.6826	98.6826	96.0602	98.6826
2036	98.6826	98.6826	98.6826	97.3206	98.6826
2037	98.6826	98.6826	98.6826	98.5887	98.6826
Years after 2037	98.6826	98.6826	98.6826	98.6826	98.6826
<i>Taxpayer Using the Composite Method</i>					
2032	98.6826	95.7515	97.8062	92.0973	96.1839

Years after 2032 Use composite method discount factors published for the relevant accident year.**

**The relevant accident year is the accident year that is ten years prior to the specified taxable year.

**SECTION 5. DISCOUNT FACTORS
FOR TAXABLE YEARS BEGINNING
IN 2022**

.01 The tables in this section 5 present separately for each line of business discount factors for losses incurred in the 2022 accident year and earlier accident years for use by insurance companies in computing discounted unpaid losses under § 846 and estimated salvage recoverable

under § 832 in taxable years beginning in 2022.

.02 Tables 3 and 4 separately provide discount factors for insurance companies that have elected to use the composite method of Notice 88-100. See Rev. Proc. 2002-74. The discount factors computed using the composite method are unrelated to the composite discount factors referred to in § 1.846-1(b)(1)(ii) and (4), which apply to lines

of business for which the Secretary has not published discount factors. The composite discount factors for use with respect to such lines of business are labelled “Short-Tail Composite” (in Table 3, part B) and “Long-Tail Composite” (in Table 4, part B). The “Miscellaneous Casualty” discount factors referenced in § 1.846-1(b)(2) are not set forth in tables but are equivalent to the “Short-Tail Composite” discount factors.

Table 3 (part A)
Discount Factors Under Section 846 (percent)
For Taxable Year(s) Beginning in 2022
Short-Tail Lines of Business

Accident Year	Auto Physical Damage	Fidelity/Surety	Financial Guaranty/ Mortgage Guaranty	International	Other*
2022	98.5087	96.0741	95.6153	96.2003	97.2283
2021	97.2290	97.2290	97.2290	97.2290	97.2290
<i>Taxpayer Not Using Composite Method</i>					
2020	98.4834	98.4834	98.4834	98.4834	98.4834
2019	98.4785	98.4785	98.4785	98.4785	98.4785
Years before 2019	98.5513	98.5513	98.5513	98.5513	98.5513
<i>Taxpayer Using the Composite Method</i>					
Years before 2021	98.4834	98.4834	98.4834	98.4834	98.4834

*For the Accident and Health line of business (other than disability income or credit disability insurance), the discount factor for taxable year 2022 is 98.6826 percent.

Table 3 (part B)
Discount Factors Under Section 846 (percent)
For Taxable Year(s) Beginning in 2022
Short-Tail Lines of Business

Accident Year	Reinsurance - Nonproportional Assumed Financial Lines	Reinsurance - Nonproportional Assumed Liability	Reinsurance - Nonproportional Assumed Property	Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary & Theft)	Warranty	Short-Tail Composite
2022	96.1755	95.3149	96.5023	97.7793	98.5010	97.4381
2021	97.2290	97.2290	97.2290	97.2290	97.2290	97.2290
<i>Taxpayer Not Using Composite Method</i>						
2020	98.4834	98.4834	98.4834	98.4834	98.4834	98.4834
2019	98.4785	98.4785	98.4785	98.4785	98.4785	98.4785
Years before 2019	98.5513	98.5513	98.5513	98.5513	98.5513	98.5513
<i>Taxpayer Using the Composite Method</i>						
Years before 2021	98.4834	98.4834	98.4834	98.4834	98.4834	98.4834

Table 4 (part A)
Discount Factors Under Section 846 (percent)
For Taxable Year(s) Beginning in 2022
Long-Tail Lines of Business

Accident Year	Commercial Auto/Truck Liability/Medical	Medical Professional Liability - Claims-Made	Medical Professional Liability - Occurrence	Multiple Peril Lines	Other Liability - Claims-Made	Other Liability - Occurrence
2022	94.5127	92.3146	87.8300	95.7799	92.0534	90.7411
2021	94.9297	92.8717	89.2979	93.8725	91.9550	90.5083
2020	95.0694	92.5421	90.0641	93.7004	91.8577	90.3548
2019	95.0945	92.8130	91.4323	92.8864	91.8764	90.4989
2018	95.2024	93.2805	92.7664	91.4064	92.0976	90.6836
2017	95.0498	93.3035	93.5069	91.6039	92.6040	90.7542
2016	95.3260	94.2423	94.3189	91.3154	93.0770	90.7788
2015	94.9804	95.1291	94.9993	91.0177	93.8378	91.9830
2014	96.4102	96.0160	96.1220	93.5200	94.9264	92.6228
2013	98.3585	97.7503	97.7902	94.8530	96.6876	94.4974
<i>Taxpayer Not Using the Composite Method</i>						
2012	98.5513	98.5513	98.5513	96.1895	98.0033	95.8511
2011	98.5513	98.5513	98.5513	97.5045	98.5513	97.2176
Years before 2011	98.5513	98.5513	98.5513	98.5513	98.5513	98.5513
<i>Taxpayer Using the Composite Method</i>						
Years before 2013	98.5513	98.5513	98.5513	96.9185	98.0920	96.7300

Table 4 (part B)
Discount Factors Under Section 846 (percent)
For Taxable Year(s) Beginning in 2022
Long-Tail Lines of Business

Accident Year	Private Passenger Auto Liability/ Medical	Products Liability - Claims-Made	Products Liability - Occurrence	Workers' Compensation	Long-Tail Composite
2022	96.1701	89.9633	89.3630	89.7304	93.8901
2021	95.4438	86.7679	89.4762	86.9319	91.9840
2020	95.0391	87.6480	89.4512	84.8651	91.0823
2019	94.6472	83.0836	90.7854	83.2721	89.8512
2018	94.2325	85.0889	89.8810	83.4129	88.7546
2017	94.2824	86.4184	89.9309	82.8905	88.6421
2016	94.5205	87.8040	90.8527	83.2567	88.6258
2015	95.0550	89.0388	91.8072	84.1036	89.1661
2014	95.6473	90.2969	92.1992	84.7150	90.3858
2013	97.7282	91.5785	94.4133	86.5946	92.1457

<i>Taxpayer Not Using the Composite Method</i>					
2012	98.5513	92.8838	95.7739	87.8065	93.4541
2011	98.5513	94.2124	97.1571	89.0414	94.7812
2010	98.5513	95.5629	98.5513	90.2995	96.1195
2009	98.5513	96.9299	98.5513	91.5813	97.4421
2008	98.5513	98.2868	98.5513	92.8867	98.5513
2007	98.5513	98.5513	98.5513	94.2154	98.5513
2006	98.5513	98.5513	98.5513	95.5661	98.5513
2005	98.5513	98.5513	98.5513	96.9334	98.5513
2004	98.5513	98.5513	98.5513	98.2913	98.5513
Years before 2004	98.5513	98.5513	98.5513	98.5513	98.5513
<i>Taxpayer Using the Composite Method</i>					
Years before 2013	98.5513	94.7288	96.6903	91.2579	95.0968

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Allan H. Sakaue of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Mr. Sakaue at (202) 317-6995 (not a toll-free number).

Administrative, Procedural, and Miscellaneous
 26 CFR 601.204: Changes in accounting periods and in methods of accounting.
 (Also, Part 1, §§ 174, 446, 1.446-1.)

Rev. Proc. 2023-11

SECTION 1. PURPOSE

This revenue procedure modifies and supersedes Rev. Proc. 2023-8, 2023-3 I.R.B. 407, which modified Rev. Proc. 2022-14, 2022-7 I.R.B. 502, to provide procedures under § 446 of the Internal Revenue Code (Code) and § 1.446-1(e) of the Income Tax Regulations to obtain automatic consent of the Commissioner of Internal Revenue (Commissioner) to change methods of accounting for specified research or experimental expenditures to comply with § 174 of the Code, as amended by § 13206 of Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). References in this revenue procedure to “former § 174”

refer to § 174 as in effect for research or experimental expenditures paid or incurred in taxable years beginning before the effective date of the amendments made to § 174 by § 13206(a) of the TCJA, and all following references to “§ 174” in this revenue procedure refer to § 174 as amended by the TCJA.

SECTION 2. BACKGROUND

.01 Former § 174.

(1) Former § 174(a)(1) provided that a taxpayer may treat research or experimental expenditures which are paid or incurred by the taxpayer during the taxable year in connection with the taxpayer’s trade or business as expenses which are not chargeable to capital account. The expenditures so treated were allowed as a deduction. Under former § 174(a)(2)(A), a taxpayer could, without the consent of the Secretary of the Treasury or her delegate (Secretary), adopt the method provided in former § 174(a) for the taxpayer’s first taxable year for which expenditures described in former § 174(a)(1) were paid or incurred. Under former § 174(a)(2)(B), a taxpayer could, with the consent of the Secretary, adopt at any time the method provided in former § 174(a).

(2) Under former § 174(b)(1), at the election of the taxpayer, made in accordance with regulations prescribed by the Secretary, research or experimental expenditures could be treated as deferred expenses if such expenditures were: 1) paid or incurred by the taxpayer in con-

nection with the taxpayer’s trade or business, 2) not treated as expenses under former § 174(a), and 3) chargeable to capital account but not chargeable to property of a character which is subject to the allowance under § 167 of the Code (relating to allowance for depreciation, etc.) or § 611 of the Code (relating to allowance for depletion).

(3) Former § 174(b)(1) provided that in computing taxable income, such deferred expenses were allowed as a deduction ratably over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures). Such deferred expenses were expenditures properly chargeable to capital account for purposes of § 1016(a)(1) of the Code (relating to adjustments to basis of property).

(4) Under former § 174(b)(2), the election provided by former § 174(b)(1) could be made for any taxable year, but only if made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The method so elected, and the period selected by the taxpayer, were required to be adhered to in computing taxable income for the taxable year for which the election was made and for all subsequent taxable years unless, with the approval of the Secretary, a change to a different method (or to a different period) was authorized with respect to part or all of such expenditures. The election did not apply to any expenditure paid or incurred during any taxable

year before the taxable year for which the taxpayer made the election.

(5) Under § 1.174-1, which applies to research or experimental expenditures paid or incurred in taxable years beginning before December 31, 2021 (the effective date of the amendments to § 174 under § 13206 of the TCJA), research or experimental expenditures which are neither treated as expenses nor deferred and amortized under § 174 must be charged to capital account.¹

.02 TCJA amendments.

(1) As amended by § 13206(a) of the TCJA, § 174(a)(1) provides that in the case of a taxpayer's specified research or experimental expenditures for any taxable year, except as provided in § 174(a)(2), no deduction is allowed for such expenditures. Section 174(a)(2) provides that the taxpayer must charge such expenditures to capital account² and is allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research within the meaning of § 41(d)(4)(F) of the Code) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. The method of accounting described in this section 2.02(1) is referred to as the "required § 174 method" in this revenue procedure.

(2) Under § 174(b) the term "specified research or experimental expenditures" means, with respect to any taxable year, research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

(3) Section 174(c)(1) provides that the required § 174 method does not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under § 167 (relating to allowance of depreciation, etc.) or § 611 (relating to allowance for depletion); but for purposes of § 174, allowances under § 167 and allowances under § 611 are considered as expenditures.

(4) Section 174(c)(2) provides that the required § 174 method does not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(5) Section 174(c)(3) provides that for purposes of § 174, any amount paid or incurred in connection with the development of any software is treated as a research or experimental expenditure accounted for under the required § 174 method.

(6) Under § 174(d), if any property with respect to which specified research or experimental expenditures are paid or incurred is disposed, retired, or abandoned during the period which such expenditures are allowed as an amortization deduction under the required § 174 method, no deduction is allowed with respect to such expenditures on account of such disposition, retirement, or abandonment and such amortization deduction will continue with respect to such expenditures.

(7) Section 13206(b) of the TCJA provides that the amendments made by § 13206(a) of the TCJA to former § 174 "shall be treated as a change in method of accounting for purposes of section 481" and that "(1) such change shall be treated as initiated by the taxpayer, (2) such change shall be treated as made with the consent of the Secretary, and (3) such change shall be applied only on a cut-off basis for any research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made."

(8) Section 13206(e) of the TCJA provides that the amendments made by § 13206(a) of the TCJA to former § 174 apply to research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

.03 Section 446(e).

(1) Except as otherwise expressly provided in the Code and the regulations thereunder, §§ 446(e) and 1.446-1(e)(2) require a taxpayer to secure the consent of the Commissioner before changing a method of accounting for Federal income tax purposes. Section 1.446-1(e)(3)

(i) states, in part, that except as otherwise provided under the authority of § 1.446-1(e)(3)(ii), to secure the Commissioner's consent to a taxpayer's change in method of accounting the taxpayer generally must file an application on Form 3115, *Application for Change in Accounting Method*, with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures under which taxpayers will be permitted to change their method of accounting. The administrative procedures will prescribe those terms and conditions necessary to obtain the Commissioner's consent to effect the change and to prevent amounts from being duplicated or omitted.

(2) Rev. Proc. 2015-13, 2015-5 I.R.B. 419, as clarified and modified by Rev. Proc. 2015-33, 2015-24 I.R.B. 1067, and as modified by Rev. Proc. 2017-59, 2017-48 I.R.B. 543, and Rev. Proc. 2021-34, 2021-35 I.R.B. 337, and as updated by Rev. Proc. 2021-26, 2021-22 I.R.B. 1163, sets forth the general procedures by which a taxpayer may obtain the automatic consent of the Commissioner to change a method of accounting described in the *List of Automatic Changes*. Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, contains the current *List of Automatic Changes*.

(3) A change in a taxpayer's treatment of specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, to comply with § 174 is a change in method of accounting to which §§ 446(e) and 481, and the corresponding regulations, apply. A taxpayer changing the treatment of specified research or experimental expenditures paid or incurred to the method of accounting that complies with § 174 must use the accounting method change procedures in Rev. Proc. 2015-13, or its successor. Section 3 of this revenue procedure modifies Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, and modifies and supersedes Rev. Proc. 2023-8, to allow taxpayers to obtain automatic consent to change their method of accounting

¹The term "capital account" in § 1.174-1 includes capital asset accounts, including, but not limited to, inventory and depreciable property.

²The term "capital account" in § 174(a)(2) does not mean the capital account described in § 1.174-1. The term means a separate specified research or experimental capital account.

to comply with § 174 for taxable years beginning after December 31, 2021.

(4) As discussed in section 2.02(7) of this revenue procedure, § 13206(b) of the TCJA provides that the amendments made by § 13206(a) of the TCJA to former § 174 are treated as a change in method of accounting for purposes of § 481 that is initiated by the taxpayer and made with the consent of the Commissioner, and that “such change shall be applied only on a cut-off basis for any research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made.” Pursuant to section 2.07 of Rev. Proc. 2015-13, when a change in method of accounting is made without a § 481(a) adjustment (for example, on a cut-off basis), in general, only the items arising on or after the beginning of the year of change, or other operative date, are accounted for under the method of accounting for which consent is granted. Any items arising before the year of change, or other operative date, continue to be accounted for under the taxpayer’s former method of accounting. When a change in method of accounting is made on a cut-off basis, no amounts are duplicated or omitted, and therefore, a § 481(a) adjustment is not necessary or permitted.

(5) In accordance with § 13206(b) of the TCJA, a change in a taxpayer’s method of accounting to the required § 174 method for the first taxable year that the amendments made by § 13206(a) of the TCJA are effective must be made only on a cut-off basis. The required § 174 method applies only to specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021. The procedures in section 3 of this revenue procedure provide an automatic change in method of accounting to the required § 174 method to comply with § 174 by filing a statement with the taxpayer’s original Federal income tax return for the first taxable year in which § 174 becomes effective in lieu of a Form 3115. If a change to the required § 174 method to comply with § 174 for some or all of the taxpayer’s specified research or experimental expenditures is made for a taxable year subsequent to the taxable year of the taxpayer in which § 174 becomes effective, the change to the required § 174

method to comply with § 174 is made by filing a Form 3115, with a modified § 481(a) adjustment that takes into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

(6) Additionally, section 3 of this revenue procedure provides a transition rule for taxpayers who filed a Federal tax return on or before this revenue procedure is published in the Internal Revenue Bulletin for a taxable year beginning after December 31, 2021. The transition rule provides that such taxpayer is deemed to have complied with the § 446 method change procedures and section 7.02 of Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, and further modified by section 3 of this revenue procedure, if the taxpayer properly reported the amount of specified research or experimental expenditures on Part VI of Form 4562, *Depreciation and Amortization*, filed with the Federal tax return, and properly capitalized and amortized such specified research or experimental expenditures in accordance with the required § 174 method.

(7) A taxpayer that changes its method of accounting for specified research or experimental expenditures under section 7.02 of Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, and further modified by section 3 of this revenue procedure, will receive limited audit protection under section 8.01 of Rev. Proc. 2015-13. Specifically, audit protection will not apply for expenditures paid or incurred in taxable years beginning before January 1, 2022. Audit protection also will not apply for expenditures paid or incurred in taxable years beginning after December 31, 2021, if a change in method is made for the taxable year immediately subsequent to the first taxable year in which § 174 becomes effective. Additionally, notwithstanding the audit protection rules under section 8.01 of Rev. Proc. 2015-13, the IRS may change the characterization or classification of expenditures as specified research or experimental expenditures as defined in § 174(b) in order to apply § 174 as well as the change under section 7.02 of Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, and further modified by section 3 of this revenue procedure, to the proper amount of expenditures paid or

incurred in each taxable year beginning after December 31, 2021.

SECTION 3. AUTOMATIC METHOD CHANGE TO REQUIRED § 174 METHOD

.01 *Modification of Section 7 of Rev. Proc. 2022-14.* Section 7 of Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, is further modified to revise section 7.02 to read as follows.

.02 *Specified Research or Experimental Expenditures.*

(1) *Description of change.*

(a) This change applies to a taxpayer that changes its method of accounting for specified research or experimental expenditures (as defined under § 174(b)) to the required § 174 method (as defined in section 7.02(1)(b) of this revenue procedure) to comply with § 174. Unless otherwise stated, references to “§ 174” in this section 7.02 refer to § 174 as amended by § 13206(a) of the TCJA. Section 13206(e) of the TCJA provides that the amendments made by § 13206 of the TCJA apply to amounts paid or incurred in taxable years beginning after December 31, 2021.

(b) Section 174(a)(1) provides that in the case of a taxpayer’s specified research or experimental expenditures for any taxable year, except as provided in § 174(a)(2), no deduction is allowed for such expenditures. Section 174(a)(2) provides that the taxpayer must charge such expenditures to capital account and is allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research within the meaning of § 41(d)(4)(f) of the Code) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. The method of accounting described in this section 7.02(1)(b) is referred to as the “required § 174 method” in this section 7.02.

(2) *Applicability.* This change to the required § 174 method applies to specified research or experimental expenditures (as defined in § 174(b)) paid or incurred in taxable years beginning after December 31, 2021.

(3) *Inapplicability.* This change does not apply to:

(a) a change in the treatment of acquired, leased, or licensed computer software under Rev. Proc. 2000-50, 2000-52 I.R.B. 601, as modified by Rev. Proc. 2007-16, 2007-1 C.B. 358 (see section 9.01 of this revenue procedure); or

(b) a change in the treatment of research or experimental expenditures under former § 174, or software development expenditures, paid or incurred in taxable years beginning before January 1, 2022 (see sections 7.01 and 9.01 of this revenue procedure).

(4) Manner of making change.

(a) *First taxable year beginning after December 31, 2021.*

(i) *Cut-off basis.* The change under section 7.02 of this revenue procedure for specified research or experimental expenditures paid or incurred in the first taxable year beginning after December 31, 2021, is implemented on a cut-off basis.

(ii) *Statement in lieu of a Form 3115 for first taxable year beginning after December 31, 2021.* Except as otherwise provided in section 7.02(5) of this revenue procedure, the requirement of § 1.446-1(e)(3)(i) to file a Form 3115, *Application for Change in Accounting Method*, is waived and a statement in lieu of a Form 3115 is authorized for the change in method of accounting under section 7.02 of this revenue procedure for which the year of change is the first taxable year beginning after December 31, 2021. Notwithstanding the definition of Form 3115 in section 3.07 of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, the statement in lieu of a Form 3115 that is permitted under this section 7.02(4)(a)(ii) is considered a Form 3115 for purposes of the automatic consent procedures of Rev. Proc. 2015-13. The requirement to file the duplicate copy, under section 6.03(1)(a) of Rev. Proc. 2015-13, is waived. The statement must include the following information for each applicant:

(A) the name and employer identification number or social security number, as applicable, of the applicant that has paid or incurred specified research or experimental expenditures after December 31, 2021;

(B) the beginning and ending dates of the first taxable year in which the change to the required § 174 method takes effect for the applicant (year of change);

(C) the designated automatic accounting method change number for this change (see section 7.02(8) of this revenue procedure);

(D) a description of the type of expenditures included as specified research or experimental expenditures;

(E) the amount of specified research or experimental expenditures paid or incurred by the applicant during the year of change; and

(F) a declaration that the applicant is changing the method of accounting for specified research or experimental expenditures to capitalize such expenditures to a specified research or experimental capital account, and amortize such amount over either a 5-year period for domestic research or 15-year period for foreign research (as applicable) beginning with the mid-point of the taxable year in which such expenditures are paid or incurred in accordance with the method permitted under § 174 for the year of change. Also, the declaration must state that the applicant is making the change on a cut-off basis.

(b) *Year of change later than the first taxable year beginning after December 31, 2021.*

(i) *Modified § 481(a) adjustment.* The change under section 7.02 of this revenue procedure for a year of change later than the first taxable year beginning after December 31, 2021, is made with a modified § 481(a) adjustment, and should take into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

(ii) *Form 3115.* In completing a Form 3115, *Application for Change in Accounting Method*, to make the change in method of accounting under section 7.02 of this revenue procedure with respect to any year of change later than the first taxable year beginning after December 31, 2021, a taxpayer must include on an attachment to Form 3115:

(A) a description of the type of expenditures included as specified research or experimental expenditures;

(B) the taxable year(s) in which the specified research or experimental expenditures subject to the change were paid or incurred by the applicant; and

(C) a declaration that the applicant is changing its method of accounting for specified research or experimental expenditures to capitalize such expenditures to a specified research or experimental capital account, and amortize such amount over either a 5-year period for domestic research or 15-year period for foreign research (as applicable) beginning with the mid-point of the taxable year in which such expenditures are paid or incurred in accordance with the method permitted under § 174 for the year of change. Also, the declaration must state that the applicant is making the change with a modified § 481(a) adjustment that takes into account only specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021.

(5) *Transition rule.* A taxpayer who filed a Federal tax return on or before January 17, 2023, for a taxable year beginning after December 31, 2021, is deemed to have complied with the § 446 method change procedures and section 7.02 of this revenue procedure to change its method of accounting for specified research or experimental expenditures paid or incurred in the first taxable year beginning after December 31, 2021, to the required § 174 method to comply with § 174 if the taxpayer:

(a) reported the amount of specified research or experimental expenditures paid or incurred for such taxable year on Part VI of Form 4562, *Depreciation and Amortization*, filed with the Federal tax return, and

(b) properly capitalized and amortized such specified research or experimental expenditures in accordance with the required § 174 method for such taxable year.

(6) *Certain eligibility rule temporarily inapplicable.* The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, does not apply to changes to the required § 174 method for the taxpayer's first taxable year beginning after December 31, 2021.

(7) *No audit protection for expenditures paid or incurred in taxable years prior to the first taxable year in which § 174 becomes effective or for a year of change that is the taxable year immediately subsequent to the first taxable year in*

which § 174 becomes effective. A taxpayer does not receive audit protection under section 8.01 of Rev. Proc. 2015-13 for the change under section 7.02 of this revenue procedure with respect to expenditures paid or incurred in taxable years beginning on or before December 31, 2021. Additionally, a taxpayer does not receive audit protection under section 8.01 of Rev. Proc. 2015-13 for the change under section 7.02 of this revenue procedure with respect to expenditures paid or incurred in taxable years beginning after December 31, 2021, if such change is made for the taxable year immediately subsequent to the first taxable year in which § 174 becomes effective. See section 8.02(2) of Rev. Proc. 2015-13.

(8) *Designated automatic accounting method change number.* The designated automatic accounting method change number for a change under section 7.02 of this revenue procedure is “265.”

(9) *No inference relating to expenditures paid or incurred in taxable years prior to the first taxable year in which § 174 becomes effective.* No inference may be drawn from section 7.02 of this revenue procedure regarding the treatment of research or experimental expenditures paid or incurred in, and changes in methods of accounting for, taxable years in which for-

mer § 174 was in effect, including issues relating to the application of §§ 1.174-1, 1.174-3, and 1.174-4 of the Income Tax Regulations for taxable years in which former § 174 was in effect.

(10) *Contact information.* For further information regarding a change under this section, contact Martha M. Garcia at (202) 317-6853 (not a toll-free number).

SECTION 4. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies section 7 of Rev. Proc. 2022-14, as modified by Rev. Proc. 2023-8, and modifies and supersedes Rev. Proc. 2023-8.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for specified research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, in which § 174 is in effect.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of

Management and Budget under OMB control numbers 1545-0074 for individual filers and 1545-0123 for business filers, in accordance with the Paperwork Reduction Act (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 the collection of information displays a valid OMB control number. The collection of information in this revenue procedure is in section 3, which adds sections 7.02(4)(a)(ii) and 7.02(4)(b)(ii) to Rev. Proc. 2022-14. This information is necessary and will be used to determine whether the taxpayer properly changed to a permitted method of accounting. The collections of information are required for the taxpayer to obtain consent to change its method of accounting.

SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Martha M. Garcia and John M. Deininger of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Martha M. Garcia or John M. Deininger at (202) 317-6853 (not a toll-free number).

Part IV

Announcement 2023-1

This announcement notifies taxpayers of the applicable reference standard required to be used to determine the amount of the energy efficient commercial building (EECB) property deduction allowed under § 179D of the Internal Revenue Code (§ 179D deduction) as amended by § 13303 of Public Law 117-169, 136 Stat. 1818, 1947 (August 16, 2022), commonly known as the Inflation Reduction Act of 2022 (IRA).¹ This announcement identifies the existing reference standard, affirms a new reference standard, and clarifies when each of the two reference standards will apply to taxpayers. The effective date of this announcement is January 1, 2023.

The Treasury Department (Treasury) and the Internal Revenue Service (IRS) plan to publish additional guidance to address IRA amendments to § 179D including, but not limited to, procedures for measuring energy use intensity to calculate the alternative deduction for energy efficient building retrofit property.

In general, a taxpayer who owns or leases a commercial building that is both located in the United States and within the scope of the applicable reference standard may be allowed a § 179D deduction equal to a portion of the cost of EECB property that the taxpayer places in service during the taxable year. Property with respect to which depreciation (or amortization in lieu of depreciation) is allowable is EECB property if it is certified to be installed on or in the building as part of one or more of three of the building's systems: (1) interior lighting systems, (2) heating, cooling, ventilation, and hot-water systems, and (3) the building's envelope. For the installation of the property on or in the building to be considered certified, the property must be certified in the manner and method prescribed by the Secretary of

the Treasury or her delegate (Secretary) as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 25 percent (50 percent for taxable years beginning before January 1, 2023) or more, in comparison to a reference building that meets the minimum requirements of the applicable reference standard using certain methods of calculation.

Since § 179D was enacted in 2005, the applicable reference standard for EECB property has been identified in § 179D(c) (2) as a version of Reference Standard 90.1 as published by the American Society of Heating, Refrigerating, and Air Conditioning Engineers (ASHRAE) and the Illuminating Engineering Society of North America (IES) (Reference Standard 90.1). For EECB property placed in service before January 1, 2015, Reference Standard 90.1-2001 applied. For EECB property placed in service after December 31, 2014, and before January 1, 2021, Reference Standard 90.1-2007 applied. For EECB property placed in service after December 31, 2020, § 179D(c)(2), as amended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020, defined "Reference Standard 90.1" to mean with respect to any property, the most recent Standard 90.1 published by the ASHRAE and the IES that has been affirmed by the Secretary, after consultation with the Secretary of Energy, for purposes of § 179D not later than the date that is 2 years before the date that construction of such property begins. Importantly, this statutory amendment changed the reference date for application of the Reference Standard 90.1 from placed in service to beginning of construction.

Section 13303 of the IRA amended § 179D for taxable years beginning after December 31, 2022. This amendment returned the reference date for application

of the Reference Standard 90.1 to the date the property is placed in service. Effective January 1, 2023, § 179D(c)(2) defines the term "Reference Standard 90.1" to mean, with respect to any property, the more recent of:

- (1) Standard 90.1-2007 published by the ASHRAE and the IES, or
- (2) The most recent Standard 90.1 published by the ASHRAE and the IES for which the Department of Energy has issued a final determination and which has been affirmed by the Secretary, after consultation with the Secretary of Energy, not later than the date that is 4 years before the date such property is placed in service.

On July 28, 2021, the Department of Energy determined the updated edition ASHRAE Reference Standard 90.1-2019² would improve energy efficiency in commercial buildings. Upon publication of this affirmative determination, each State was required to review the provisions of their commercial building code regarding energy efficiency, and, as necessary, update their codes to meet or exceed Reference Standard 90.1-2019 not later than 2 years from July 28, 2021.

The Secretary, after consultation with the Secretary of Energy, hereby affirms ASHRAE Reference Standard 90.1-2019 as the applicable Reference Standard 90.1 for purposes of calculating the annual energy and power consumption and costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the reference building as follows: In the case of property the construction of which begins after December 31, 2022, ASHRAE 90.1-2019 will be the applicable standard for property that is placed in service after December 31, 2026. Taxpayers who already began or will begin construction by December 31, 2022, or who already placed property in service or will place property in service by December 31, 2026, are not

¹ Section 179D was added to Internal Revenue Code by § 1331(a) of the Energy Tax Incentives Act of 2005, Public Law 109-58, 119 Stat. 594, 1020 (August 8, 2005) as a temporary provision and was temporarily extended in 2006, 2008, 2014, 2015, 2018, and 2019. Section 179D was made permanent by § 102(a) of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted as Division EE of the Consolidated Appropriations Act, 2021, Public Law 116-260, 134 Stat. 1182, 3039 (December 27, 2020).

² Final Determination Regarding Energy Efficiency Improvements in ANSI/ASHRAE/IES Standard 90.1-2019, 86 FR 40543-44 (July 28, 2021).

subject to the updated Reference Standard 90.1-2019. For such property, the

applicable Reference Standard 90.1 is Reference Standard 90.1-2007. The table

below reflects the applicable Reference Standard 90.1.

Date Placed In Service	Applicable Reference Standard 90.1
Before 1/1/2015	Reference Standard 90.1-2001
After 12/31/2014 and before 1/1/2027*	Reference Standard 90.1-2007
After 12/31/2026*	Reference Standard 90.1-2019

* Taxpayers who begin construction before 1/1/2023 may apply Reference Standard 90.1-2007 regardless of when the building is placed in service.

The principal author of this announcement is Rika Valdman of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this announcement contact Ms. Valdman at 202-317-6853 (not a toll-free number).

Notice of Proposed Rulemaking

Guidance on the Foreign Government Income Exemption and the Definition of Domestically Controlled Qualified Investment Entities

REG-100442-22

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations regarding the treatment of certain entities, including qualified foreign pension funds, for purposes of the exemption from taxation afforded to foreign governments (the “proposed regulations”). The proposed regulations also address the determination of whether a qualified investment entity is domestically controlled, including the treatment of qualified foreign pension funds for this purpose.

DATES: Written or electronic comments and requests for a public hearing must be received by February 27, 2023.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-100442-22) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury and the IRS will publish for public availability any comments submitted electronically and comments submitted on paper to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG-100442-22), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning §1.892-5, Joel Deuth at (202) 317-6938; concerning §1.897-1, Arielle Borsos at (202) 317-6937; concerning submissions of comments or requests for a public hearing, Regina Johnson at (202) 317-5177 (not toll-free numbers) or publichearings@irs.gov.

SUPPLEMENTARY INFORMATION:

Background

I. Section 892

Section 892(a)(1) of the Internal Revenue Code (the “Code”) exempts from U.S. taxation certain income derived by a foreign government. This exemption, however, does not apply to income that is (1) derived from the conduct of a commercial activity (whether within or out-

side the United States), (2) received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity, or (3) derived from the disposition of an interest in a controlled commercial entity. Section 892(a)(2)(A).

Section 892(a)(2)(B) provides that for purposes of section 892(a)(2)(A), a controlled commercial entity is any entity engaged in commercial activities (whether within or outside the United States) and in which a foreign government holds (directly or indirectly) interests according to specified thresholds. The term “entity” in section 892(a)(2)(B) means a corporation, a partnership, a trust, and an estate. *See* §1.892-5(a)(3).

A United States real property holding corporation (“USRPHC”), as defined in section 897(c)(2), or a foreign corporation that would be a USRPHC if it was a United States corporation, is treated as engaged in commercial activity and, therefore, is a controlled commercial entity if a foreign government meets certain ownership or control thresholds with respect to that USRPHC or foreign corporation. §1.892-5T(b)(1).

II. Section 897

Section 897(a)(1) provides that gain or loss of a nonresident alien individual or foreign corporation from the disposition of a United States real property interest (“USRPI”) is taken into account under section 871(b)(1) or 882(a)(1), as applicable, as if the nonresident alien individual or foreign corporation were engaged in a trade or business within the United States during the taxable year and such gain or loss were effectively connected with that trade or business.

Subject to certain exceptions, section 897(c)(1)(A) defines a USRPI as an interest in real property (including an interest in a mine, well, or other natural deposit) located in the United States or the Virgin Islands, and any interest (other than solely as a creditor) in any domestic corporation unless the taxpayer establishes that such corporation was at no time a USRPHC during the period set forth in section 897(c)(1)(A)(ii) (generally, the five-year period ending on the date of the disposition of the interest). Under section 897(c)(2), a USRPHC is generally any corporation if the fair market value of its USRPIs equals or exceeds 50 percent of the aggregate fair market value of its USRPIs, its interests in real property located outside the United States, plus any other of its assets that are used or held for use in a trade or business.

Section 897(h)(1) provides that any distribution by a qualified investment entity (“QIE”) to a nonresident alien individual, a foreign corporation, or other QIE, to the extent attributable to gain from sales or exchanges by the QIE of USRPIs, is treated as gain recognized by such nonresident alien individual, foreign corporation, or other QIE from the sale or exchange of a USRPI, subject to certain exceptions. Section 897(h)(4)(A) defines a QIE as any (i) real estate investment trust (“REIT”), and (ii) any regulated investment company (“RIC”) which is a USRPHC or which would be a USRPHC if the exceptions in section 897(c)(3) and 897(h)(2) did not apply to interests in any REIT or RIC.

Section 897(h)(2) provides that a USRPI does not include an interest in a domestically controlled QIE (“DC-QIE exception”). Accordingly, gain or loss on the disposition of stock in a domestically controlled QIE is not subject to section 897(a) (other than to the extent provided in section 897(h)(1)). Section 897(h)(4)(B) provides that a QIE is domestically controlled if less than 50 percent of the value of its stock is held directly or indirectly by foreign persons at all times during the testing period prescribed in section 897(h)(4)(D) (generally, the five-year period ending on the date of the disposition). The legisla-

tive history accompanying the enactment of section 897 indicates that Congress intended for the DC-QIE exception to apply to entities controlled by United States persons. *See* H.R. Conf. Rep. No. 96-1479, at 188 (1980) (“In the case of REITs which are controlled by U.S. persons, sales of the REIT shares by foreign shareholders would not be subject to tax (other than in the case of distribution by the REIT).”). Section 1.897-9T(c) defines “foreign person” for purposes of section 897 as a nonresident alien individual (including an individual subject to the provisions of section 877), a foreign corporation (as defined in §1.897-1(l)), a foreign partnership, a foreign trust, or a foreign estate, as such persons are defined respectively by §1.871-2 and by section 7701 and the regulations thereunder.¹ Under §1.897-1(l), the term “foreign corporation” generally has the meaning ascribed to it in section 7701(a)(3) and 7701(a)(5) and §301.7701-5.

Section 897(h)(3) provides that in the case of a domestically controlled QIE, rules similar to those in section 897(d) (which prescribes rules requiring the recognition of gain on the distribution of a USRPI by a foreign corporation) apply to the foreign ownership percentage of any gain. Section 897(h)(4)(C) provides that the term “foreign ownership percentage” means the percentage of QIE stock that was held (directly or indirectly) by foreign persons at the time during the testing period (as defined in section 897(h)(4)(D)) during which the direct and indirect ownership of stock by foreign persons was greatest.

Section 1.897-1(c)(2)(i), which was issued when section 897(h) addressed only domestically controlled REITs, defines domestically controlled REITs (rather than QIEs) and otherwise restates the rule in section 897(h)(2).² Section 1.897-1(c)(2)(i) does not address the determination of whether stock of a REIT is considered “held directly or indirectly by foreign persons” under section 897(h)(4)(B) and provides only that, for purposes of determining the ownership of the REIT’s stock, actual ownership under §1.857-8 must be

taken into account. Section 1.857-8(b) states that the actual owner of stock of a REIT is the person who is required to include in gross income in his return the dividends received on the stock and is generally the shareholder of record of the REIT.

Section 897(h)(4)(E), which was added to the Code in section 322(b)(1)(A) of the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-113, div. Q (the “PATH Act”), provides special ownership rules for determining the holder of QIE stock under section 897(h)(4)(B) and 897(h)(4)(C). Section 897(h)(4)(E)(i) states that, in the case of any class of stock of the QIE that is regularly traded on an established securities market in the United States (“U.S. publicly traded QIE stock”), a person holding less than five percent of such class of stock at all times during the testing period is treated as a United States person unless the QIE has actual knowledge that such person is not a United States person. Section 897(h)(4)(E)(ii) provides that any stock in the QIE held by another QIE (i) any class of stock of which is regularly traded on an established securities market, or (ii) which is a RIC that issues redeemable securities within the meaning of section 2 of the Investment Company Act of 1940 (an entity described in (i) or (ii), a “public QIE”) is treated as held by a foreign person, except that if the public QIE is domestically controlled (determined after the application of section 897(h)(4)(E)), such stock is treated as held by a United States person. Finally, section 897(h)(4)(E)(iii) provides that any stock in the QIE held by a QIE that is not a public QIE (“non-public QIE”) is only treated as held by a United States person in proportion to the stock of the non-public QIE that is (or is treated under section 897(h)(4)(E)(ii) or 897(h)(4)(E)(iii) as) held by a United States person.

Section 897(l) provides an exception to the application of section 897(a) for certain foreign pension funds and their wholly owned subsidiaries. Section 897(l) was added to the Code in section 323(a) of the PATH Act. As originally enacted, section 897(l)(1) provided that section 897 does not apply to any USRPI held directly (or

¹ Section 1.897-9T(a) provides that §1.897-9T(c) (the definition of “foreign person”) would appear as §1.897-1(k) if and when §1.897-9T is adopted as a final regulation.

² Section 897(h) did not apply to RICs when the regulations were finalized. Section 411 of the American Jobs Creation Act of 2004, Public Law 108-357 (2004), amended section 897(h) to apply to certain RICs in addition to REITs and introduced the term QIE to include such entities.

indirectly through one or more partnerships) by, or to any distribution received from a REIT by, a qualified foreign pension fund (“QFPF”) or any entity all of the interests of which are held by a QFPF. Congress later made several technical amendments to section 897(l) in section 101(q) of the Tax Technical Corrections Act of 2018, Pub. L. 115-141, div. U (the “Technical Corrections Act”). As amended in the Technical Corrections Act, section 897(l) provides that neither a QFPF nor an entity all the interests of which are held by a QFPF is treated as a nonresident alien individual or foreign corporation for purposes of section 897. Section 897(l)(3) provides the Secretary with the authority to “prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.”

On June 7, 2019, the Department of the Treasury (“Treasury Department”) and the IRS published proposed regulations in the **Federal Register** (84 FR 26605) (the “2019 proposed regulations”) under sections 897(l), 1441, 1445 and 1446. The 2019 proposed regulations contained rules relating to qualification for the exception under section 897(l), as well as rules relating to withholding requirements under sections 1441, 1445 and 1446, for dispositions of USRPIs by, and distributions described in section 897(h) received by, QFPFs and entities that are wholly owned by one or more QFPFs (“qualified controlled entities,” or “QCEs”). The 2019 proposed regulations are finalized in the Final Rules section of this issue of the **Federal Register**.

Explanation of Provisions

I. Coordination of Exemption Under Section 897(l) with Section 892

The exemption from U.S. taxation provided to foreign governments by section 892 does not apply to income derived from the conduct of a commercial activ-

ity, or income received by a controlled commercial entity or received (directly or indirectly) from a controlled commercial entity. Section 1.892-4T(a). Section 1.892-5T(b)(1) treats a USRPHC (or a foreign corporation that would be a USRPHC if it was a United States corporation) as engaged in commercial activity and, therefore, a controlled commercial entity if it is controlled by a foreign government pursuant to §1.892-5T(a).

A QFPF would be a controlled commercial entity for section 892 purposes if it qualified as a USRPHC within the meaning of §1.892-5T(b)(1) and if it were controlled by a foreign government pursuant to §1.892-5T(a). In such case, none of the income, including, for example, from investments in the United States in stocks or securities, received by the foreign government from that QFPF would be eligible for the section 892 exemption. A comment to the 2019 proposed regulations noted that §1.892-5T(b)(1) incentivizes a government-controlled QFPF to reduce its USRPIs to preserve the exemption provided by section 892. In addition, the comment noted that §1.892-5T(b)(1) may necessitate that such a QFPF monitor its USRPIs for section 892 purposes despite being exempt from the application of section 897(a). The comment recommended that a QFPF and a QCE be excluded from the application of §1.892-5T(b)(1) or that §1.892-5T(b)(1) be withdrawn.

Although these proposed regulations do not withdraw the rule entirely, the Treasury Department and the IRS agree that the rule in §1.892-5T(b)(1) should not apply to a QFPF or a QCE, and these proposed regulations therefore adopt that recommendation. Proposed §1.892-5(b)(1)(ii)(A). In addition, the proposed regulations exclude certain other USRPHCs from the application of §1.892-5T(b)(1). Proposed §1.892-5(b)(1)(ii)(B). Excluding certain other USRPHCs from the application of §1.892-5T(b)(1) is consistent with the policy of section 892 with respect

to deemed commercial activities. For example, in general, a foreign government under section 892 currently is not treated as engaging in commercial activities by reason of investing in stocks, bonds, and other securities. §1.892-4T(c)(1)(i).³ The proposed regulations add another category by excluding from the application of §1.892-5T(b)(1) a corporation that is a USRPHC solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government. Thus, for example, if a foreign government controls a USRPHC whose only assets are minority interests in REITs, the proposed regulations would not treat that corporation as a controlled commercial entity pursuant to §1.892-5T(b)(1). The changes to §1.892-5T(b)(1) made by the proposed regulations do not affect the analysis of whether the income itself is exempt from U.S. taxation under section 892.⁴

The proposed regulations also clarify §1.892-5T(b)(1) by replacing the phrase “or a foreign corporation that would be a United States real property holding corporation if it was a United States corporation” with “which may include a foreign corporation” when referencing section 897(c)(2) to define a USRPHC. Proposed §1.892-5(b)(1)(i). Section 897(c)(2) defines a USRPHC as including “any corporation”, whether domestic or foreign.⁵ Thus, the phrase “or a foreign corporation that would be a United States real property holding corporation if it was a United States corporation” when referencing the definition in section 897(c)(2) is unnecessary.

II. Effect of Section 897(l) on DC-QIE Exception

A comment received in response to the 2019 proposed regulations recommended that regulations clarify that a QFPF is treated as a domestic person for purposes of the DC-QIE exception. The comment

³Regulations proposed under section 892 in 2011 would also extend the policy embodied by §1.892-4T(c)(1)(i) with respect to deemed commercial activities by providing that investments in financial instruments will not be treated as commercial activities for purposes of section 892, irrespective of whether such financial instruments are held in the execution of governmental financial or monetary policy. See proposed §1.892-4(e)(1)(i). See also proposed §§1.892-4(e)(1)(iv) and 1.892-5(d)(5)(iii), which provide relief from being treated as engaged in certain deemed commercial activities.

⁴See, for example, proposed §1.892-4(e)(1)(iv), which provides that gain derived from a disposition of a USRPI defined in section 897(c)(1)(A)(i) will not qualify for exemption from taxation under section 892 even though a disposition (including a deemed disposition under section 897(h)(1)) of a USRPI, by itself, does not constitute the conduct of a commercial activity.

⁵In contrast, section 897(c)(1)(A)(ii) defines a USRPI by reference to an interest in a USRPHC that is a domestic corporation.

reasoned that section 897(l)(1) states that a QFPF shall not be treated as a nonresident alien individual or foreign corporation for purposes of all of section 897, which includes the DC-QIE exception. The comment also noted that such a rule would be easily administrable for open-ended investment funds and would provide certainty to such funds and their investors that section 897(a) would not apply to the disposition of interests in open-ended investment funds which have QFPFs as significant investors. Another comment, however, stated that it is not clear that the intent behind section 897(l) was to provide that a QIE is domestically controlled if it is majority owned by QFPFs, as there was no indication that Congress intended that result. The comment recommended that regulations provide how QFPFs are to be treated for purposes of the DC-QIE exception but did not recommend a specific result.

Section 897(a) generally applies with respect to the gain or loss of “a nonresident alien individual or a foreign corporation.” In addition, section 897(h)(1) applies to any distribution by a QIE to a nonresident alien individual or a foreign corporation (or other QIE). Section 897(l) provides that, for purposes of section 897, a QFPF shall not be treated as “a nonresident alien individual or a foreign corporation.” The reference to “a nonresident alien individual or a foreign corporation” in section 897(l) therefore is consistent with the same class of persons subject to tax under section 897(a) and 897(h)(1). Thus, under the statute, when a QFPF disposes of a USRPI, section 897(a) does not apply to any gain or loss from the disposition because section 897(l) treats the QFPF as neither a nonresident alien individual nor a foreign corporation. Similarly, when a QFPF receives a distribution from a QIE that is attributable to gain from the sale or exchange of a USRPI, the look-through rule under section 897(h)(1), and the general rule under section 897(a) do not apply because section 897(l) treats the QFPF as neither a nonresident alien individual nor a foreign corporation.

In contrast, the ownership test in section 897(h)(4)(B) for the DC-QIE ex-

ception (which predates the enactment of section 897(l)) uses the term “foreign persons” and not “nonresident individuals or foreign corporations.” The DC-QIE exception applies to scenarios where a nonresident alien individual or foreign corporation disposes of stock in a QIE, but because the QIE is less than 50 percent owned by “foreign persons,” the stock disposed of is not considered a USRPI. Although section 897(l) provides that a QFPF is not treated as a nonresident alien individual or a foreign corporation for purposes of section 897, it does not expressly provide that a QFPF or QCE is not treated as a foreign person for purposes of the separate ownership test of the DC-QIE exception.

There is no indication that Congress intended for section 897(l) to provide that QFPFs and QCEs are not treated as foreign persons for purposes of applying the DC-QIE exception to other foreign persons that are neither QFPFs nor QCEs. As originally enacted in the PATH Act, section 897(l) provided that section 897 did not apply to USRPIs held, and REIT distributions received, by a QFPF and a QCE but did not alter the status of the QFPF or QCE. As a result, as originally enacted section 897(l) turned off the application of section 897(a) to the QFPF or QCE.

In the same legislation, Congress also amended the rules in the DC-QIE exception. See PATH Act secs. 133 and 322.⁶ Certain amendments to the DC-QIE exception deem ownership in a QIE as ownership by a United States or foreign person depending on whether certain conditions are met. See section 897(h)(4)(E)(i), 897(h)(4)(E)(ii). These amendments demonstrate that Congress knows how to directly identify the deemed classification of investors as foreign persons or United States persons and did so in one part of the PATH Act through amendments to the DC-QIE exception. Congress could have made a similar modification to the DC-QIE exception for QFPFs and QCEs in the same legislation but did not do so.

The Technical Corrections Act modified the language of section 897(l). In particular, the modified language specifies that a QFPF and a QCE are not treated as

nonresident alien individuals or foreign corporations for purposes of section 897. The Joint Committee on Taxation explanation of the technical correction for section 897(l) states that the revised language was merely intended to clarify the language specifying which entities qualified for the benefit provided by the new subsection. See STAFF OF THE JOINT COMM. ON TAX’N, General Explanation of Tax Legislation Enacted in the 115th Congress (JCS-2-19) (General Explanation) 145 (2019) (“2019 General Explanation”). Although the 2019 General Explanation does not specify the technical error with the PATH Act language that was corrected by the 2018 amendment, when comparing the technical correction to the PATH Act formulation, the correction clearly allows a QFPF and QCE to jointly own a USRPI and qualify for section 897(l) with respect to their partial interests in it, whereas the PATH Act formulation used “or” between QFPF and QCE, which suggested that all of the USRPI had to be owned by a single entity. Additionally, the change clarified that the exception applied to distributions from all QIEs and not just REITs. Lastly, by shifting the focus of section 897(l) from applying to the USRPI in the PATH Act formulation (“[T]his section shall not apply to any United States real property interest held by...”) to instead applying to the QFPF in the Technical Corrections Act formulation (“[F]or purposes of this section, a qualified foreign pension fund shall not be treated as...”), the technical correction aligned the section 897(l) exception with the operative provision in section 897(a), which modifies the tax treatment of the entity receiving income via disposition or distribution (the QFPF or QCE), not the tax treatment of the USRPI itself.

Ultimately, as a technical correction, the modification to section 897(l) cannot expand on the policy Congress intended to enact in the PATH Act. A technical correction is a change that clarifies existing law, such as through correcting errors, rather than one that fundamentally or substantively changes the law. See *Fed. Nat’l Mortgage Assoc. v. United States*, 56 Fed. Cl. 228, 234, 237 (2003), *rev’d and remanded on other grounds*, 379 F.3d

⁶ Those amendments did not relate to the new rules in section 897(l) and are described separately in the Joint Committee on Taxation’s General Explanation. See STAFF OF THE JOINT COMM. ON TAX’N, General Explanation of Tax Legislation Enacted in 2015 (JCS-1-16) (General Explanation) 155, 280-83 (2016) (“PATH Act General Explanation”).

1303 (Fed. Cir. 2004) (“Congress turns to technical corrections when it wishes to clarify existing law or repair a scrivener’s error, rather than to change the substantive meaning of the statute. . . . [A] technical correction that merely restores the rule Congress intended to enact cannot be construed as a fundamental change in the operation of the statute.”); STAFF OF THE JOINT COMM. ON TAX’N, Overview of Revenue Estimating Procedures and Methodologies Used by the Staff of the Joint Committee on Taxation (JCX-1-05) 33 (2005) (describing a technical correction as “legislation that is designed to correct errors in existing law in order to fully implement the intended policies of previously enacted legislation” and a change that “conforms to and does not alter the intent” of the underlying legislation). Both the PATH Act General Explanation and the 2019 General Explanation make clear that the intent of section 897(l), as originally enacted and as corrected, was to provide that “in determining the U.S. income tax of a qualified foreign pension fund, section 897 does not apply.” See 2019 General Explanation, at 145. This intent was also clear in the original language of section 897(l) and could not have been expanded by the modifications in the Technical Corrections Act. Additionally, because section 897(l) already specifically excludes QFPF and QCEs from the application of section 897(a), treating them as not being a foreign person for purposes of the DC-QIE exception would serve only to benefit other foreign investors in the same QIE. Nothing in the statute or legislative history indicates that majority ownership of a QIE by a QFPF or QCE should allow other investors to avoid section 897, and such treatment does not follow from the policy of either section 897(l) or the DC-QIE exception as expressed in the legislative history of those provisions. Further, if Congress had intended for a QFPF to not be treated as a “foreign person,” which is a different and broader characterization beyond section 897(l)’s treatment as not “a nonresident alien individual or a foreign corporation,” which is needed to turn off section 897(a) as to the QFPF or QCE, Congress presumably would have expressly provided for that result. Cf. section 1445(f)(3)(B) (solely for purposes of section 1445, providing that an entity that

is exempt under section 897(l) is not a foreign person) and section 897(h)(4)(E) (as discussed, treating certain QIE investors as foreign persons (even if in fact a domestic corporation)).

Accordingly, proposed §1.897-1(c)(3)(iv)(A) provides that a QFPF (including any part of a QFPF) or a QCE is a foreign person for purposes of the DC-QIE exception. See parts III and IV of this Explanation of Provisions for a discussion of the definition of domestically controlled QIE in proposed §1.897-1(c)(3). The IRS may challenge contrary positions before the issuance of any final regulations regarding the treatment of a QFPF or QCE for purposes of the DC-QIE exception.

The proposed regulations make related changes to the definitions provided in §1.897-1. Proposed §1.897-1(k) and (l) revise the definition of “foreign person” (as provided in §1.897-9T(c)) and “foreign corporation” to remove references that are no longer applicable and to add cross references to the rule in proposed §1.897-1(c)(3)(iv)(A).

III. *QIE Stock Held Directly or Indirectly Under Section 897(h)(4)(B)*

A. *Overview*

The proposed regulations provide guidance for determining whether stock of a QIE is considered “held directly or indirectly” by foreign persons for determining whether a QIE is domestically controlled under section 897(h)(4)(B). The proposed regulations define stock that is held “indirectly” by taking into account stock of the QIE held through certain entities under a limited “look-through” approach. The look-through approach balances the policies of the DC-QIE exception with the requirement in section 897(h)(4)(B) to take into account “indirect” ownership of QIE stock by foreign persons in determining whether a QIE is domestically controlled. It is also intended to prevent the use of intermediary entities to achieve results contrary to the purposes of the DC-QIE exception.

Questions have arisen as to whether the reference to stock held “indirectly” in section 897(h)(4)(B) could be interpreted to require looking through all entities, including, for example, all domestic and

foreign corporations, to determine the extent to which the ultimate individual shareholders of a QIE are foreign or domestic. In its broadest sense, the statute refers to stock held “indirectly” by foreign persons, which could encompass ownership by a foreign individual through multiple tiers of entities of any type. However, the Treasury Department and the IRS have concluded that the term “indirectly” should not be interpreted so broadly given the policy underlying section 897(h)(4). Section 897(h)(4)(B) indicates that the determination of whether a QIE is domestically controlled looks to ownership of QIE stock by “foreign persons,” not just individuals. In addition, such a broad interpretation of “indirectly” mandating the look-through of all entity types, including through multiple tiers of entities, would likely be difficult for taxpayers to comply with, and for the IRS to administer, particularly with respect to publicly traded entities.

Notwithstanding that a complete look-through approach is inappropriate, the Treasury Department and the IRS are issuing proposed §1.897-1(c)(3) based on the conclusion that a look-through approach in determining “indirect” ownership of a QIE should still apply in specified circumstances to QIE stock held by intermediary entities. The proposed regulations thus address the treatment of QIE stock held by certain intermediary entities, such as domestic partnerships. For example, assume USR, a REIT, holds a USRPI as its sole asset. Nonresident alien individuals hold 49 percent of USR’s single class of stock. PRS, a domestic partnership 50 percent of the interests of which are held by each of two foreign corporations, holds the remaining 51 percent of the USR stock. If USR stock is disposed of, taxpayers may assert that the stock is not a USRPI under the DC-QIE exception, and therefore not subject to section 897(a), because PRS is a United States person and, consequently, foreign persons could be viewed as directly or indirectly holding less than 50 percent of USR’s stock by value. Taxpayers may assert this position even though, taking into account the USR stock held by the foreign corporations through their interests in PRS, foreign persons hold directly or indirectly all of USR’s outstanding stock. In support of this position, taxpay-

ers may point to §1.897-1(c)(2)(i) and its reference to §1.857-8 as suggesting that the inclusion of the dividends received on QIE stock in gross income on a domestic partnership's tax return, without regard to stock held indirectly by another person, establishes the partnership not only as the actual owner of QIE stock but, as a result of such actual ownership, as the only relevant person for determining whether a QIE is domestically controlled. Taxpayers may take this position even though the determination of actual ownership pursuant to §1.857-8 is only intended to ensure the beneficial owner of stock is taken into account when different from the shareholder of record, and §1.897-1(c)(2)(i) does not state or otherwise suggest that the actual owners of QIE stock as determined under §1.857-8 are the only relevant persons for determining whether a QIE is domestically controlled or provide any guidance on the meaning of "held directly or indirectly by foreign persons."

The Treasury Department and the IRS have concluded that the interpretation of the DC-QIE exception described in the preceding paragraph is incorrect because it would permit nonresident alien individuals and foreign corporations to dispose of USRPIs held indirectly through certain intermediate entities, such as domestic partnerships, to avoid taxation under section 897(a). To prevent this result, entities such as partnerships that are generally not subject to U.S. Federal income tax should not, subject to certain limited exceptions, be treated as holders of QIE stock for purposes of determining whether a QIE is domestically controlled. This type of look-through analysis is consistent with section 897(h)(4)(B), which references "indirect" ownership in determining the shareholders of a QIE that should be taken into account in applying the DC-QIE exception.

B. General Look-Through Approach

Consistent with the reference to stock held "indirectly" by foreign persons in section 897(h)(4)(B), the determination of whether a QIE is domestically controlled under the proposed regulations generally applies a "look-through" approach to stock of a QIE that is held through certain entities. Thus, in determining whether a QIE is domestically controlled, only a "non-

look-through person" is treated as holding directly or indirectly stock of a QIE, and stock of a QIE held by or through one or more intervening "look-through persons" is treated as held proportionately by the look-through person's ultimate owners that are non-look-through persons. Proposed §1.897-1(c)(3)(ii)(A) and (B).

Proposed §1.897-1(c)(3)(ii)(C) provides that stock of a QIE considered held directly or indirectly by a non-look-through person is not considered held directly or indirectly by any other person. Under this rule, for example, if stock of a QIE is held directly or indirectly by a domestic C corporation (that is not a foreign-owned domestic corporation), it is treated as held directly or indirectly only by that domestic C corporation and is not treated as held directly or indirectly by non-look-through shareholders of the domestic C corporation (or any other person).

Subject to a special look-through rule for foreign-owned domestic corporations and the special ownership rules in section 897(h)(4)(E), discussed in parts III.C and III.D of this Explanation of Provisions, respectively, the proposed regulations define a "non-look-through person" to include persons such as individuals, "domestic C corporations" (defined as a domestic corporation other than an S corporation, a REIT or a RIC) and foreign corporations (including, for the avoidance of doubt, foreign governments pursuant to section 892(a)(3)). Proposed §1.897-1(c)(3)(v) (D). The definition of a non-look-through person also includes "nontaxable holders" (defined to include tax-exempt entities under section 501(a) or the United States, a State, a U.S. territory, an Indian tribal government or any subdivision of the foregoing) because they generally do not have owners to which the look-through approach could apply. For the same reason, the definition of a "non-look-through person" includes international organizations (as defined in section 7701(18)). In addition, a non-look-through person includes publicly traded partnerships (domestic or foreign) because it may be difficult to look-through such entities and it is unlikely that these entities could be affirmatively used as intermediary entities to create a domestically controlled QIE. Finally, a non-look-through person includes a QPFP

(including any part of a QPFP) or QCE, which ensures that such entities are taken into account as foreign persons for purposes of section 897(h)(4)(B) as provided under proposed §1.897-1(c)(3)(iv)(A).

A "look-through person" is defined as any person that is not a non-look-through person and includes, for example, a REIT or a RIC (subject to the special ownership rule in proposed §1.897-1(c)(3)(iii)(C)), an S corporation, a non-publicly traded partnership (domestic or foreign), and a trust (domestic or foreign). Proposed §1.897-1(c)(3)(v)(C).

C. Special Look-Through Rule for Foreign-Owned Domestic Corporations

Even though domestic C corporations are generally treated as non-look-through persons, the Treasury Department and the IRS are issuing proposed §1.897-1(c)(3)(iii)(B) based on the conclusion that a limited look-through approach should apply to non-publicly traded domestic C corporations in which foreign persons hold a meaningful ownership interest. This rule would, for example, prevent the use of intermediary domestic C corporations by foreign investors to create domestically controlled QIEs that could exempt from the application of section 897 QIE stock held directly by those or other foreign investors. In such cases, the ownership of the domestic C corporation by foreign persons should be ascertainable and taken into account in determining the "indirect" ownership of the QIE by foreign persons in applying section 897(h)(4)(B).

Accordingly, in determining whether a QIE is domestically controlled, the proposed regulations treat a domestic C corporation whose stock is not regularly traded on an established securities market ("non-public domestic C corporation") as a look-through person, but only if the non-public domestic C corporation is a foreign-owned domestic corporation. Proposed §1.897-1(c)(3)(iii)(B). For this purpose, a "foreign-owned domestic corporation" is any non-public domestic C corporation if foreign persons hold directly or indirectly 25 percent or more of the fair market value of the corporation's outstanding stock. Proposed §1.897-1(c)(3)(v)(B). Whether a non-public domestic C corporation is a foreign-owned domestic

corporation is determined by, in general, applying the same look-through rules that apply in determining whether a QIE is domestically controlled. Thus, for example, stock of the domestic corporation held by look-through persons would be treated as held directly or indirectly by the look-through person's shareholders, partners, or beneficiaries for this purpose.

D. Special Ownership Rules in Section 897(h)(4)(E)

The proposed regulations incorporate the special ownership rules in section 897(h)(4)(E)(i) and 897(h)(4)(E)(ii). These rules treat a person that holds stock in a QIE as a non-look-through person to the extent required to ensure the treatment of such person as a foreign or United States person as prescribed under section 897(h)(4)(E)(i) and 897(h)(4)(E)(ii). Thus, a person holding less than five percent of U.S. publicly traded QIE stock that section 897(h)(4)(E)(i) deems to be a United States person (absent actual knowledge by the QIE that such person is not a United States person) is treated under the proposed regulations as a non-look-through person with respect to that stock. Proposed §1.897-1(c)(3)(iii)(A). Stock of a QIE held by a public QIE that, under section 897(h)(4)(E)(ii), is treated as held by a foreign or United States person based on whether the public QIE is a domestically controlled QIE is similarly treated under the proposed regulations as held by a non-look-through person (even though the general definition of a non-look-through person excludes QIEs). Proposed §1.897-1(c)(3)(iii)(C).

For QIE stock held by a non-public QIE, whose ownership should be more readily ascertainable, the general look-through rules in the proposed regulations are consistent with the approach in section 897(h)(4)(E)(iii) that looks to the proportionate ownership of the non-public QIE to determine the QIE stock held by United States persons.

The rule in proposed §1.897-1(c)(3)(iii)(A) regarding U.S. publicly traded QIE stock applies notwithstanding any other provision under proposed §1.897-1(c)(3) (rules regarding domestically controlled QIEs). Thus, for example, a QFPF that holds less than five percent of U.S. public-

ly traded QIE stock at all times during the testing period (and absent actual knowledge that the person is not a United States person), is treated as a United States person that is a non-look through person with respect to that stock even though the QFPF would otherwise be treated as a foreign person under proposed §1.897-1(c)(3)(iv)(A). The Treasury Department and the IRS have determined that this priority rule is appropriate due to the administrative and compliance difficulties that could result in determining whether other rules would, absent the application of the U.S. publicly traded QIE rule, treat less-than-five-percent holders of U.S. publicly traded QIE stock as foreign persons.

IV. QIE Stock Held Directly or Indirectly Under Section 897(h)(4)(C)

As noted in the Background section of this preamble, section 897(h)(4)(C) provides that the term “foreign ownership percentage” means the percentage of QIE stock that was held (directly or indirectly) by foreign persons at the time during the testing period during which the direct and indirect ownership of stock by foreign persons was greatest. The Treasury Department and the IRS have concluded that the determination of QIE stock held “directly or indirectly” in section 897(h)(4)(C) should be interpreted in the same manner as such phrase is interpreted in the definition of a domestically controlled QIE in section 897(h)(4)(2). Accordingly, proposed §1.897-1(c)(4) provides that for purposes of calculating the foreign ownership percentage, the determination of the QIE stock that was held directly or indirectly by foreign persons is made under the rules that apply for purposes of determining whether a QIE is domestically controlled.

V. Other Rules and Modifications

The proposed regulations treat international organizations (as defined in section 7701(18)) as foreign persons for purposes of determining whether a QIE is domestically controlled. Proposed §1.897-1(c)(3)(iv)(B). Notwithstanding that international organizations are generally not treated as foreign persons for section 897 purposes under §1.897-9T(e), the Treasury Depart-

ment and the IRS believe that, for reasons similar to those described in part II of this Explanation of Provisions regarding QFPFs and QCEs, and because international organizations would not otherwise constitute United States persons under section 7701(a)(30), international organizations should be treated as foreign persons in applying the DC-QIE exception.

The proposed regulations do not retain the reference to §1.857-8 in §1.897-1(c)(2)(i), which is not necessary given the rules provided in the proposed regulations for determining whether stock of a QIE is considered to be held directly or indirectly. The look-through rules set forth in proposed §1.897-1(c)(3) apply only with respect to determining whether a QIE is domestically controlled under section 897(h)(4)(B) and do not apply with respect to any other provision, including section 897(c)(3).

Finally, the proposed regulations revise the definition of domestically controlled REIT in §1.897-1(c)(2)(i) to reflect amendments to section 897(h) made after those regulations were issued that extended the application of section 897(h) to certain RICs. Accordingly, the proposed regulations replace the definition of “domestically controlled REIT” in §1.897-1(c)(2)(i) by defining a “domestically controlled QIE” in proposed §1.897-1(c)(3).

Applicability Dates

The regulations under section 892 are proposed to apply to taxable years ending on or after December 28, 2022. Taxpayers may rely on the proposed regulations under section 892 until the date of publication of the Treasury decision adopting the regulations as final in the **Federal Register**.

Subject to a special rule for entity classification elections, the regulations under section 897 are proposed to apply to transactions occurring on or after the date these regulations are published as final regulations in the **Federal Register**; however, rules applicable for determining whether a QIE is domestically controlled may be relevant for determining QIE ownership during periods before the date these regulations are published as final regulations in the **Federal Register** to the extent the testing period related to a transaction that

occurs after the date these regulations are published as final regulations in the **Federal Register** includes periods before that date. The IRS may challenge positions contrary to proposed §1.897-1(c)(3) and (4) before the issuance of final regulations relating to the topics addressed in those proposed rules.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

The Administrator of the Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget, has determined that this proposed rule is not a significant regulatory action, as that term is defined in section 3(f) of Executive Order 12866. Therefore, OIRA has not reviewed this proposed rule pursuant to section 6(a)(3)(A) of Executive Order 12866 and the April 11, 2018, Memorandum of Agreement between the Treasury Department and the Office of Management and Budget (“OMB”).

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) generally requires that a Federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit. There are no additional information collection requirements associated with these proposed regulations.

III. Regulatory Flexibility Act

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (5 U.S.C. chapter 6) (“RFA”) requires the agency “to prepare and make available for public comment an initial regulatory flexibility analysis” that will “describe the impact of the proposed rule on small entities.” See 5 U.S.C. 603(a). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities. A small entity is defined as a small business, small non-

profit organization, or small governmental jurisdiction. See 5 U.S.C. 601(3) through (6).

The Treasury Department and the IRS do not expect that proposed §1.892-5(b)(1) will have a significant economic impact on a substantial number of small entities within the meaning of sections 601(3) through 601(6) of the RFA. Proposed §1.892-5(b)(1) provides guidance regarding whether certain foreign government-controlled entities may be treated as controlled commercial entities within the meaning of section 892. Proposed §1.892-5(b)(1) does not impose any new costs on these entities. Consequently, the Treasury Department and the IRS do not expect that proposed §1.892-5(b)(1) will have a significant economic impact on a substantial number of small entities.

Because there is a possibility, however, of significant economic impact on a substantial number of small entities as a result of the rules relating to the treatment of QFPFs and QCEs for purposes of the DC-QIE exception and the definition of a domestically controlled QIE, an initial regulatory flexibility analysis for the proposed regulations is provided below. The Treasury Department and the IRS request comments from the public on the number of small entities that may be impacted and whether that impact will be economically significant.

A. Reasons Why Action is Being Considered

As discussed in part II of the Explanation of Provisions, there may be some uncertainty as to whether QFPFs and QCEs, which are treated as not “nonresident alien individuals or foreign corporations” for purposes of section 897, are treated as foreign persons for purposes of the DC-QIE exception. Treating QFPFs and QCEs as non-foreign investors for purposes of the DC-QIE exception has the potential to expand the effect of section 897(l) to foreign investors who are neither QFPFs nor QCEs (by exempting such investors from tax under section 897(a)). These regulations eliminate any uncertainty that taxpayers may have as to the proper classification of QFPFs and QCEs for purposes of the DC-QIE exception by providing that QFPFs and QCEs are treated as for-

foreign persons for purposes of the DC-QIE exception.

As discussed in part III of the Explanation of Provisions, there is uncertainty regarding the determination of whether stock of a QIE is held “directly or indirectly” by foreign persons for purposes of the DC-QIE exception. These regulations provide rules to clarify this determination.

B. Objectives of and Legal Basis for the Proposed Regulations

These regulations clarify the treatment of QFPFs and QCEs for two purposes: the first is for purposes of the section 892 exemption from taxation for foreign governments, and the second is the DC-QIE exception. The rules are intended to ensure the following: (1) foreign government-controlled QFPFs (and QCEs) that qualify for the exemption under section 897(l) (and certain other foreign government entities) are not treated as controlled commercial entities for section 892 purposes by reason of qualifying as a USR-PHC, and (2) the exemption under section 897(l) does not inappropriately inure to non-QFPFs or non-QCEs by treating QFPFs and QCEs as domestic investors for purposes of the DC-QIE exception. These regulations also clarify whether stock of a QIE is held “directly or indirectly” by foreign persons in determining whether the DC-QIE exception applies. The legal basis for these regulations is contained in sections 892(c), 897(l) and 7805.

C. Small Entities to Which These Regulations Will Apply

The regulation relating to the treatment of QFPFs and QCEs for purposes of the DC-QIE exception affects other foreign investors in QIEs. The regulation defining a domestically controlled QIE also affects foreign investors in QIEs. Because an estimate of the number of small businesses affected is not currently feasible, this initial regulatory flexibility analysis assumes that a substantial number of small businesses will be affected. The Treasury Department and the IRS do not expect that these regulations will affect a substantial number of small non-profit organizations or small governmental jurisdictions.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

These regulations do not impose additional reporting or recordkeeping obligations.

E. Duplicate, Overlapping, or Relevant Federal Rules

The Treasury Department and the IRS are not aware of any Federal rules that duplicate, overlap, or conflict with these regulations.

F. Alternatives Considered

Section 897(a) applies to nonresident alien individuals and foreign corporations, and neither the statute nor prior regulations establish different rules for small entities. Moreover, the DC-QIE exception is measured based on the ownership interests in a QIE, regardless of the size of the investor. Because the DC-QIE exception takes into account all investors, regardless of size, the Treasury Department and the IRS have concluded that the DC-QIE exception should apply uniformly to large and small business entities. The Treasury Department and the IRS did not consider any significant alternative to the rule that provides for the treatment of QFPFs and QCEs under the DC-QIE exception, or for the rule relating to QFPFs, QCEs, or certain other foreign government entities under section 892.

The Treasury Department and the IRS did consider alternatives for the rule that defines a domestically controlled QIE, including one alternative that generally would treat all domestic C corporations as non-look through persons (that is, without the special rule for foreign-owned domestic corporations discussed in part III.C of the Explanation of Provisions section of this preamble). However, the Treasury Department and the IRS concluded that the look-through approach in the proposed rules best serves the purposes of the DC-QIE exception while also taking into account “indirect” ownership of QIE stock by foreign persons in determining whether a QIE is domestically controlled under section 897(h)(4)(B). As noted in part III.C of the Explanation of Provisions

section of this preamble, the purpose of the special rule for foreign-owned domestic corporations is to prevent the use of intermediary domestic C corporations by foreign investors to create domestically controlled QIEs that could exempt from the application of section 897 QIE stock held directly by those or other foreign investors.

The proposed rules address potential uncertainty under current law and do not impose an additional economic burden. Consequently, the rules represent the approach with the least economic impact.

IV. *Section 7805(f)*

Pursuant to section 7805(f) of the Code, the proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

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 proposed 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.

VI. *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 proposed regulations do not have federalism implications, do not impose substantial direct compliance costs on State and local governments, and

do not preempt State law within the meaning of the Executive order.

Comments and Requests for Public Hearing

Before the proposed amendments are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “ADDRESS-ES” section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations, including the definitions of look-through person and non-look-through person, and whether special treatment for particular entities, such as cooperatives, may be warranted. Any electronic and paper comments submitted will be made available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Statement of Availability of IRS Documents

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

Drafting Information

The principal authors of these regulations are Arielle Borsos and Joel Deuth of the 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.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

PART 1—INCOME TAXES

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

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

* * * * *

Section 1.897-1 also issued under 26 U.S.C. 897(l)(3).

* * * * *

Par. 2. Section 1.892-5, as proposed to be amended in 76 FR 68119 (November 3, 2011), is further amended by revising paragraphs (b) through (d) to read as follows:

§1.892-5 Controlled commercial entity.

* * * * *

(b) *Entities treated as engaged in commercial activity*—(1) *United States real property holding corporations*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, a United States real property holding corporation as defined in section 897(c)(2), which may include a foreign corporation, is treated as engaged in commercial activity and, therefore, is a controlled commercial entity if the requirements of §1.892-5T(a)(1) or (2) are satisfied.

(ii) *Exceptions.* Paragraph (b)(1)(i) of this section does not apply to the following—

(A) A foreign corporation that is a qualified holder under §1.897(l)-1(d); or

(B) A corporation that is a United States real property holding corporation, as defined in section 897(c)(2), solely by reason of its direct or indirect ownership interest in one or more other corporations that are not controlled by the foreign government (as determined under §1.892-5T(a)).

(iii) *Applicability date.* This paragraph (b)(1) applies to taxable years ending on

or after December 28, 2022. For rules that apply to taxable years ending before December 28, 2022, *see* §1.892-5T(b)(1), as contained in 26 CFR part 1, revised as of April 1, 2022.

(b)(2) through (d)(4). For further guidance, *see* §1.892-5T(b)(2) through (d)(4). * * * * *

Par. 3. Section 1.892-5T is amended by revising paragraph (b)(1) to read as follows:

§1.892-5T Controlled commercial entity (temporary regulations).

* * * * *

(b) * * *

(1)(i) For further guidance, *see* §1.892-5(b)(1)(i).

(ii) For further guidance, *see* §1.892-5(b)(1)(ii).

* * * * *

Par 4. Section 1.897-1 is amended by:

- a. Revising paragraph (a)(2);
- b. Removing and reserving paragraph (c)(2)(i);
- c. Adding paragraphs (c)(3) and (4);
- d. Adding paragraph (k);
- e. Removing the language “or section 897(k) and §1.897-4” in the second sentence and adding two sentences to the end of paragraph (l); and
- f. Adding paragraph (n).

The revision and additions read as follows:

§1.897-1 Taxation of foreign investment in United States real property interests, definition of terms.

(a) * * *

(2) *Effective date.* Except as otherwise provided in this paragraph (a)(2), the regulations set forth in §§1.897-1 through 1.897-4 are effective for transactions occurring after June 18, 1980. Paragraphs (c)(3) and (4), (k), and (l) of this section apply to transactions occurring on or after [the date these regulations are published as final regulations in the **Federal Register**] and transactions occurring before [the date these regulations are published as final regulations in the **Federal Register**] resulting from an entity classification election under §301.7701-3 of this chapter that was effective on or before [the date these regulations are published

as final regulations in the **Federal Register**] but was filed on or after [DATE OF PUBLICATION OF FINAL RULE]. For transactions occurring before [DATE OF PUBLICATION OF FINAL RULE], *see* paragraphs (c)(2)(i) and (l) of this section and §1.897-9T(c) as in effect and contained in 26 CFR part 1, as revised April 1, 2022.

* * * * *

(c) * * *

(3) *Domestically controlled QIE*—(i) *In general.* An interest in a domestically controlled QIE is not a United States real property interest. A QIE is domestically controlled if foreign persons hold directly or indirectly less than 50 percent of the fair market value of the QIE’s outstanding stock at all times during the testing period. For rules that apply to distributions by a QIE (including a domestically controlled QIE) attributable to gain from the sale or exchange of a United States real property interest, *see* section 897(h)(1).

(ii) *Look-through approach for determining QIE stock held directly or indirectly.* The following rules apply for purposes of determining whether a QIE is domestically controlled:

(A) *Non-look-through persons considered holders.* Only a non-look-through person is considered to hold directly or indirectly stock of the QIE.

(B) *Attribution from look-through persons.* Stock of a QIE that, but for the application of paragraph (c)(3)(ii) (A) of this section, would be considered held by a look-through person, is instead considered held directly or indirectly by the look-through person’s shareholders, partners, or beneficiaries, as applicable, that are non-look-through persons based on the non-look-through person’s proportionate interest in the look-through person. To the extent the shareholders, partners, or beneficiaries, as applicable, of the look-through person are also look-through persons, this paragraph applies to such shareholders, partners, or beneficiaries as if they held, but for the application of paragraph (c)(3)(ii)(A) of this section, their proportionate share of the stock of the QIE.

(C) *No attribution from non-look-through persons.* Stock of a QIE considered held directly or indirectly by a non-look-through person is not considered

held directly or indirectly by any other person.

(iii) *Special rules for applying look-through approach*—(A) *Certain holders of U.S. publicly traded QIE stock.* Notwithstanding any other provision of paragraph (c)(3) of this section, a person holding less than five percent of U.S. publicly traded QIE stock at all times during the testing period, determined without regard to paragraph (c)(3)(ii)(A) of this section, is treated as a United States person that is a non-look-through person with respect to that stock, unless the QIE has actual knowledge that such person is not a United States person. For an example illustrating the application of this paragraph (c)(3)(iii)(A), see paragraph (c)(3)(vi)(C) of this section.

(B) *Certain foreign-owned domestic C corporations.* A non-public domestic C corporation is treated as a look-through person if it is a foreign-owned domestic corporation. For an example illustrating the application of this paragraph (c)(3)(iii)(B), see paragraph (c)(3)(vi)(B) of this section.

(C) *Public QIEs.* A public QIE is treated as a foreign person that is a non-look-through person. The preceding sentence does not apply, however, if the public QIE is a domestically controlled QIE as defined in paragraph (c)(3) of this section, determined after the application of this paragraph (c)(3)(iii)(C), in which case the public QIE is treated as a United States person that is a non-look-through person. For an example illustrating the application of this paragraph (c)(3)(iii)(C), see paragraph (c)(3)(vi)(C) of this section (*Example 3*).

(iv) *Treatment of certain persons as foreign persons*—(A) *Qualified foreign pension fund or qualified controlled entity.* For purposes of paragraph (c)(3) of this section, a qualified foreign pension fund (including any part of a qualified foreign pension fund) or a qualified controlled entity is treated as a foreign person, irrespective of whether the fund or entity qualifies for the exception from section 897 provided in §1.897(l)-1(b)(1). For an example illustrating the application of this paragraph (c)(3)(iv)(A), see paragraph (c)(3)(vi)(A) of this section (*Example 1*). See also paragraph (k) of this section for a definition of foreign person that applies for purposes of sections 897, 1445, and 6039C.

(B) *International organization.* For purposes of paragraph (c)(3) of this section, an international organization (as defined in section 7701(a)(18)) is treated as a foreign person. See §1.897-9T(e) regarding the treatment of international organizations under sections 897, 1445, and 6039C, which provides that an international organization is not a foreign person with respect to United States real property interests, and is not subject to sections 897, 1445, and 6039C on the disposition of a United States real property interest.

(v) *Definitions.* The following definitions apply for purposes of paragraph (c)(3) of this section:

(A) A *domestic C corporation* is any domestic corporation other than a regulated investment company (“RIC”) as defined in section 851, a real estate investment trust (“REIT”) as defined in section 856, or an S corporation as defined in section 1361.

(B) A *foreign-owned domestic corporation* is any non-public domestic C corporation if foreign persons hold directly or indirectly 25 percent or more of the fair market value of the non-public domestic C corporation’s outstanding stock. For purposes of determining whether a non-public domestic C corporation is a foreign-owned domestic corporation, the rules of paragraphs (c)(3)(ii)(A) through (C) and (c)(3)(iii)(C) of this section apply with the following modifications—

(1) In paragraphs (c)(3)(ii)(A) through (C) of this section, treating references to “QIE” as references to “non-public domestic C corporation”; and

(2) A non-public domestic C corporation that is a foreign-owned domestic corporation under paragraph (c)(3)(v)(B) of this section is treated as a look-through person for purposes of determining whether any other non-public domestic C corporation is a foreign-owned domestic corporation.

(C) A *look-through person* is any person other than a non-look-through person. Thus, for example, a look-through person includes a RIC, a REIT, an S corporation, a non-publicly traded partnership (domestic or foreign), and a trust (domestic or foreign, whether or not the trust is described in sections 671 through 679). For a special rule that treats certain non-public domestic C corporations as look-through

persons, see paragraph (c)(3)(iii)(B) of this section.

(D) A *non-look-through person* is an individual, a domestic C corporation (other than a foreign-owned domestic corporation), a nontaxable holder, a foreign corporation (including a foreign government pursuant to section 892(a)(3)), a publicly traded partnership (domestic or foreign), an estate (domestic or foreign), an international organization (as defined in section 7701(a)(18)), a qualified foreign pension fund (including any part of a qualified foreign pension fund), or a qualified controlled entity. For special rules that treat certain holders of QIE stock as non-look-through persons, see paragraphs (c)(3)(iii)(A) and (C) of this section.

(E) A *non-public domestic C corporation* is any domestic C corporation that is not a public domestic C corporation.

(F) A *nontaxable holder* is—

(1) Any organization that is exempt from taxation by reason of section 501(a);

(2) The United States, any State (as defined in section 7701(a)(10)), any territory of the United States, or a political subdivision of any State or any territory of the United States; or

(3) Any Indian tribal government (as defined in section 7701(a)(40)) or its subdivision (determined in accordance with section 7871(d)).

(G) A *public domestic C corporation* is a domestic C corporation any class of stock of which is regularly traded on an established securities market within the meaning of §§1.897-1(m) and 1.897-9T(d).

(H) A *public QIE* is a QIE any class of stock of which is regularly traded on an established securities market within the meaning of §§1.897-1(m) and 1.897-9T(d), or that is a RIC that issues redeemable securities within the meaning of section 2 of the Investment Company Act of 1940.

(I) A *publicly traded partnership* is a partnership any class of interest of which is regularly traded on an established securities market within the meaning of §§1.897-1(m) and 1.897-9T(d).

(J) A *qualified controlled entity* has the meaning set forth in §1.897(l)-1(e)(9).

(K) A *qualified foreign pension fund* has the meaning set forth in §1.897(l)-1(c).

(L) A QIE is a qualified investment entity, as defined in section 897(h)(4)(A).

(M) *Testing period* has the meaning set forth in section 897(h)(4)(D).

(N) *U.S. publicly traded QIE stock* is any class of stock of a QIE that is regularly traded on an established securities market within the meaning of §§1.897-1(m) and 1.897-9T(d), but only if the established securities market is in the United States.

(vi) *Examples.* The rules of this paragraph (c)(3) are illustrated by the following examples. It is presumed that each entity has a single class of stock or other ownership interests, that the ownership described existed throughout the relevant testing period and that, unless otherwise stated, a QIE is not a public QIE as defined under paragraph (c)(3)(v)(H) of this section.

(A) *Example 1: QIE stock held by public domestic C corporation—(1) Facts.* USR is a REIT, 51 percent of the stock of which is held by X, a public domestic C corporation as defined in paragraph (c)(3)(v)(G) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section.

(2) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR is a QIE. X is a non-look-through person as defined under paragraph (c)(3)(v)(D) of this section. Thus, under paragraph (c)(3)(ii)(A) of this section X is considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(C) of this section, the USR stock held directly or indirectly by X is not considered held directly or indirectly by any other person, including the shareholders of X. Because X is not a foreign person as defined in paragraph (k) of this section and holds directly or indirectly 51 percent of the single class of outstanding stock of USR, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR, and USR therefore is a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(3) *Alternative facts: QIE stock held by domestic partnership.* The facts are the same as in paragraph (c)(3)(vi)(A)(1) of this section (*Example 1*), except that, instead of being a public domestic C corporation, X is a domestic partnership that is not a publicly traded partnership as defined in paragraph (c)(3)(v)(I) of this section. In addition, FC1, a foreign corporation, holds a 50 percent interest in X, and the remaining interests in X are held by U.S. citizens. X is a look-through person as defined in paragraph (c)(3)(v)(C) of this section and, therefore, under paragraph (c)(3)(ii)(A) of this section is not considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(B) of this section, the stock of USR that, but for paragraph (c)(3)(ii)(A) of this section, is considered held by X, a look-through person, is instead considered

held proportionately by X's partners that are non-look-through persons. Accordingly, because FC1 and the U.S. citizen partners in X are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, 25.5 percent of the stock of USR is considered as held directly or indirectly by FC1 (50% x 51%), a foreign person as defined in paragraph (k) of this section, and 25.5 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen partners in X (50% x 51%), who are not foreign persons as defined in paragraph (k) of this section. Foreign persons therefore hold directly or indirectly 74.5 percent of the stock of USR (49 percent of the stock of USR held directly or indirectly by nonresident alien individuals, who are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 25.5 percent held directly or indirectly by FC1), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section. The result described in this paragraph (c)(3)(vi)(A)(3) would be the same if, instead of being a domestic partnership, X were a foreign partnership.

(4) *Alternative facts: QIE stock held by a qualified foreign pension fund.* The facts are the same as in paragraph (c)(3)(vi)(A)(3) of this section (*Example 1*), except that, instead of being a foreign corporation, FC1 is a qualified foreign pension fund. The analysis is the same as in paragraph (c)(3)(vi)(A)(3) of this section regarding the treatment of X as a look-through person as defined in paragraph (c)(3)(v)(C) of this section. FC1, a foreign person under paragraph (c)(3)(iv)(A) of this section, is a non-look-through person as defined in paragraph (c)(3)(v)(D) of this section. Because FC1 and the U.S. citizen partners in X are non-look-through persons, 25.5 percent of the stock of USR is considered as held directly or indirectly by FC1 (50% x 51%), and 25.5 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen partners in X (50% x 51%). Foreign persons therefore hold directly or indirectly 74.5 percent of the stock of USR (49 percent of the stock of USR held directly or indirectly by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 25.5 percent held directly or indirectly by FC1), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(B) *Example 2: QIE stock held by non-public domestic C corporation that is a foreign-owned domestic corporation—(1) Facts.* USR is a REIT, 51 percent of the stock of which is held by X, a non-public domestic C corporation as defined in paragraph (c)(3)(v)(E) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section. FC1, a foreign corporation, holds 20 percent of the stock of X, and Y, a nonresident alien individual, holds 5 percent of the stock of X. The remaining 75 percent of the stock of X is held by U.S. citizens.

(2) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR is a QIE. X is a non-look-through person as defined under paragraph (c)(3)(v)(D) of this section, unless paragraph (c)(3)(iii)(B) of this section applies to treat X as a look-through person

because X is a foreign-owned domestic corporation. FC1, Y, and the U.S. citizen shareholders of X are non-look-through persons as defined under paragraph (c)(3)(v)(D) of this section. Under paragraph (c)(3)(v)(B)(1) of this section, FC1, Y, and the U.S. citizen shareholders are all considered as holding directly or indirectly stock of X for purposes of determining whether X is a foreign-owned domestic corporation. Under paragraph (c)(3)(v)(B)(1) of this section, the stock held directly or indirectly by FC1, Y, and the U.S. citizen shareholders is not considered held directly or indirectly by any other person. Because FC1 and Y, both foreign persons as defined in paragraph (k) of this section, hold directly or indirectly 20 percent and 5 percent of the stock of X, respectively, foreign persons hold directly or indirectly 25 percent of the fair market value of the stock of X, and X is a foreign-owned domestic corporation under paragraph (c)(3)(v)(B) of this section. Accordingly, under paragraph (c)(3)(iii)(B) of this section, X is a look-through person as defined in paragraph (c)(3)(v)(C) of this section and, therefore, under paragraph (c)(3)(ii)(A) of this section is not considered as holding directly or indirectly stock of USR for purposes of determining whether USR is a domestically controlled QIE. Under paragraph (c)(3)(ii)(B) of this section, the stock of USR that, but for paragraph (c)(3)(ii)(A) of this section, is considered held by X, a look-through person, is instead considered held proportionately by X's shareholders that are non-look-through persons. Accordingly, because FC1, Y, and the U.S. citizen shareholders of X are non-look-through persons, 10.2 percent of the stock of USR is considered as held directly or indirectly by FC1 (20% x 51%), 2.55 percent of the stock of USR is considered as held directly or indirectly by Y (50% x 51%), and 38.25 percent (in the aggregate) of the stock of USR is considered as held directly or indirectly by the U.S. citizen shareholders (75% x 51%). Foreign persons therefore hold directly or indirectly 61.75 percent of the stock of USR (49 percent of the stock of USR held directly by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 10.2 percent and 2.55 percent held indirectly by FC1 and Y, respectively), and USR is not a domestically controlled QIE under paragraph (c)(3)(i) of this section. The result described in this paragraph (c)(3)(vi)(B)(2) would be different if Y were a U.S. citizen instead of a nonresident alien individual, in which case X would be a non-look-through person because it is not a foreign-owned domestic corporation under paragraph (c)(3)(v)(B) of this section and, consequently, USR would be a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(C) *Example 3: QIE stock held by public QIE that is a domestically controlled QIE—(1) Facts.* USR2 is a REIT, 51 percent of the stock of which is held by USR1, a REIT that is a public QIE as defined in paragraph (c)(3)(v)(H) of this section, and 49 percent of the stock of which is held by nonresident alien individuals, which are foreign persons as defined in paragraph (k) of this section. The stock of USR1 is U.S. publicly traded QIE stock as defined in paragraph (c)(3)(v)(N) of this section. FC1 and FC2,

both foreign corporations, each hold 20 percent of the stock of USR1. The remaining 60 percent of the stock of USR1 is held by persons that each hold less than 5 percent of the stock of USR1 and with respect to which USR1 has no actual knowledge that such person is not a United States person (“USR1 small public shareholders”).

(2) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR2 and USR1 are QIEs. Under paragraph (c)(3)(iii)(A) of this section, each of the USR1 small public shareholders is treated as a United States person that is a non-look-through person. Consequently, under paragraph (c)(3)(i) of this section USR1 is a domestically controlled QIE because FC1 and FC2, each a foreign person as defined in paragraph (k) of this section, together hold directly or indirectly only 40 percent of the stock of USR1 and, thus, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR1. In addition, the USR2 stock held by USR1 is treated as held directly or indirectly by a United States person that is a non-look-through person under paragraph (c)(3)(iii)(C) of this section. Because USR1 holds directly or indirectly 51 percent of the stock of USR2, foreign persons hold directly or indirectly less than 50 percent of the fair market value of the stock of USR2, and USR2 is a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(3) *Alternative facts: QIE stock held by public QIE that is not a domestically controlled QIE.* The facts are the same as in paragraph (c)(3)(vi)(C)(I) of this section (Example 3), except that 25 percent of the stock of USR1 is held by each of FC1 and FC2, with the remaining 50 percent of the stock of USR1 held by the USR1 small public shareholders. Regardless of the treatment of the USR1 small public shareholders, USR1 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section because FC1 and FC2, each a foreign person as defined in paragraph (k) of this section, together hold directly or indirectly 50 percent of the stock of USR1 and, thus, foreign persons do not hold directly or indirectly less than 50 percent of the fair market value of the stock of USR1. In addition, the USR2 stock held by USR1 is treated as held by a foreign person that is a non-look-through person under paragraph (c)(3)(iii)(C) of this section. Because USR1 holds directly or indirectly 51 percent of the stock of USR2, foreign persons do not hold directly or indirectly less than 50 percent of the fair market value of the stock of USR2, and USR2 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(D) *Example 4: QIE stock held by non-public QIE—(I) Facts.* USR2 is a REIT, 49 percent of the stock of which is held by nonresident alien individuals, and 51 percent of the stock of which is held by USR1, a REIT. U.S. citizens hold 50 percent of the stock of USR1. The remaining 50 percent of the stock of USR1 is held by PRS, a domestic partnership, 50 percent of the interests in which are held by DC, a public domestic C corporation as defined in paragraph (c)(3)(v)(G) of this section, and 50 percent of the interests in which are held by nonresident alien individuals.

(2) *Analysis.* Under paragraph (c)(3)(v)(L) of this section, USR2 and USR1 are QIEs. USR1 is

not treated as a non-look-through person under paragraph (c)(3)(iii)(C) of this section because USR1 is not a public QIE as defined in paragraph (c)(3)(v)(H) of this section. Each of USR1 and PRS is a look-through person as defined in paragraph (c)(3)(v)(C) of this section that is not treated as holding directly or indirectly stock in USR2 for purposes of determining whether USR2 is a domestically controlled QIE under paragraph (c)(3)(ii)(A) of this section. Under paragraph (c)(3)(ii)(B) of this section, stock of a QIE that would be considered held by a look-through person but for the application of paragraph (c)(3)(ii)(A) of this section is considered held directly or indirectly proportionately by the look-through person’s direct or indirect owners that are non-look-through persons. Because the U.S. citizens who hold USR1 stock are non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, those U.S. citizens are treated as holding directly or indirectly 25.5 percent of the stock of USR2 through their USR1 stock interest (50% x 51%) in accordance with paragraph (c)(3)(ii)(A) of this section. Similarly, because DC and the nonresident alien partners in PRS are non-look-through persons, each is treated as holding directly or indirectly the stock of USR2 through its interest in PRS and PRS’s interest in USR1. Thus, DC is treated as holding directly or indirectly 12.75 percent of the stock of USR2 (50% x 50% x 51%) and the nonresident alien individual partners, which are foreign persons as defined in paragraph (k) of this section, are treated as directly or indirectly holding a 12.75 percent aggregate interest in the stock of USR2 (50% x 50% x 51%). Foreign persons therefore hold directly or indirectly 63.25 percent of the stock of USR2 (the 49 percent stock in USR2 directly held by nonresident alien individuals, who are foreign persons and non-look-through persons as defined in paragraph (c)(3)(v)(D) of this section, plus the 12.75 percent in stock indirectly held by the nonresident alien individual partners in PRS), and USR2 is not a domestically controlled QIE under paragraph (c)(3)(i) of this section.

(4) *Foreign ownership percentage.* For purposes of calculating the foreign ownership percentage under section 897(h)(4)(C), the determination of the QIE stock that was held directly or indirectly by foreign persons is made under the rules of paragraphs (c)(3)(ii) through (vi) of this section.

(k) *Foreign person.* The term *foreign person* means a nonresident alien individual (including an individual subject to the provisions of section 877), a foreign corporation as defined in paragraph (l) of this section, a foreign partnership, a foreign trust or a foreign estate, as such persons are defined by section 7701 and the regulations in this chapter under section 7701. A resident alien individual, including a nonresident alien individual with

respect to whom there is in effect an election under section 6013(g) or 6013(h) to be treated as United States resident, is not a foreign person. With respect to the status of foreign governments and international organizations, see §1.897-9T(e). See paragraph (c)(3)(iv)(A) of this section regarding the treatment of qualified foreign pension funds and qualified controlled entities as foreign persons for purposes of section 897(h)(4)(B).

(l) *** For purposes of sections 897 and 6039C, however, the term does not include a foreign corporation with respect to which there is in effect an election under section 897(i) and §1.897-3 to be treated as a domestic corporation. For purposes of section 897, the term does not include a qualified holder described in §1.897(l)-1(d); see paragraph (c)(3)(iv)(A) of this section regarding the treatment of qualified foreign pension funds and qualified controlled entities as foreign persons for purposes of section 897(h)(4)(B).

(n) See §1.897-9T(d) for a definition of regularly traded for purposes of sections 897, 1445, and 6039C.

Par. 5. Section 1.897-9T is amended by removing and reserving paragraph (c) and adding a sentence after the second sentence of paragraph (e).

The addition reads as follows:

§1.897-9T Treatment of certain interest in publicly traded corporations, definition of foreign person, and foreign governments and international organizations (temporary).

(e) *** See §1.897-1(c)(3)(iv)(B) regarding the treatment of international organizations as foreign persons for purposes of section 897(h)(4)(B). ***

Melanie R. Krause,
Acting Deputy Commissioner for
Services and Enforcement.

(Filed by the Office of the Federal Register December 28, 2022, 8:45a.m., and published in the issue of the Federal Register for December 29, 2022, 87 FR 80097)

Notice of Proposed Rulemaking

Income of Foreign Governments and International Organizations; Comment Period Reopening

REG-146537-06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; reopening of comment period.

SUMMARY: The Department of the Treasury and the IRS are reopening the comment period for REG-146537-06, relating to the exemption from taxation afforded to foreign governments under section 892.

DATES: The comment period for REG-146537-06, 76 FR 68119 (November 3, 2011), as corrected by 76 FR 72367 (November 23, 2011) (the “2011 proposed regulations”), is reopened, and additional written or electronic comments and requests for a public hearing must be received by February 27, 2023.

ADDRESSES: Commenters are strongly encouraged to submit additional public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov

(indicate IRS and REG-146537-06) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (the “Treasury Department”) and the Internal Revenue Service (the “IRS”) will publish for public availability any comment submitted electronically, and on paper, to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG-146537-06), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-146537-06), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Joel Deuth at (202) 317-6938; concerning submissions of comments or requests for a public hearing, Vivian Hayes at (202) 317-5306 (not toll-free numbers) or by sending an email to publichearings@irs.gov (preferred).

SUPPLEMENTARY INFORMATION: Generally, the 2011 proposed regulations provide guidance relating to the exemption from taxation afforded to foreign governments from qualified investments in the United States under section 892 of the Internal Revenue Code. The Treasury Department and the IRS are considering finalizing the 2011 proposed regulations and, therefore, are reopening the comment period with respect to the 2011 proposed

regulations for 60 days. Comments that were previously submitted in accordance with the 2011 proposed regulations will be considered and do not need to be submitted again in response to this reopening of the comment period. The 2011 proposed regulations may be finalized in conjunction with finalizing the proposed regulations published in this issue of the **Federal Register** regarding the treatment of certain entities for purposes of the section 892 exemption that relate in some respects to certain provisions of the 2011 proposed regulations.

REQUESTS FOR PUBLIC HEARING: A public hearing will be scheduled if requested in writing by any person who timely submits written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4, 2020-17 IRB 667, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Oluwafunmilayo A. Taylor,
Chief,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel,
(Procedure and Administration).

(Filed by the Office of the Federal Register December 28, 2022, 8:45a.m., and published in the issue of the Federal Register for December 29, 2022, 87 FR 80108)

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 2022–27 through 2022–52 is in Internal Revenue Bulletin 2022–52, dated December 27, 2022.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2022–27 through 2022–52 is in Internal Revenue Bulletin 2022–52, dated December 27, 2022.

Internal Revenue Service

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

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page (www.irs.gov) or write to the Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.