

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2011-11, page 758.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for May 2011.

T.D. 9521, page 750.

Final regulations under section 904(d) of the Code provide transition rules regarding the reduction of the number of separate foreign tax credit limitation categories.

REG-154159-09, page 777.

Proposed regulations under section 108(a) of the Code relate to the exclusion from gross income of discharge of indebtedness income of a grantor trust or an entity that is disregarded as an entity separate from its owner. The regulations provide rules regarding the term "taxpayer" for purposes of applying section 108 to discharge of indebtedness income of a grantor trust or a disregarded entity.

Notice 2011-21, page 761.

To provide a more uniform method for the federal income taxation of Treasury Inflation-Protected Securities (TIPS), this notice provides that the IRS and the Department of the Treasury plan to issue regulations that will provide that the coupon bond method described in regulations section 1.1275-7(d) applies to TIPS issued with more than a *de minimis* amount of premium. The regulations will be effective for TIPS issued on or after April 8, 2011.

Notice 2011-34, page 765.

This notice provides further guidance to Notice 2010-60 and requests comments regarding implementation of chapter 4 of the Code. Notice 2010-60 supplemented and superseded.

EMPLOYEE PLANS

Notice 2011-33, page 761.

Weighted average interest rate update; corporate bond indices; 30-year Treasury securities; segment rates. This notice contains updates for the corporate bond weighted average interest rate for plan years beginning in April 2011; the 24-month average segment rates; the funding transitional segment rates applicable for April 2011; and the minimum present value transitional rates for March 2011.

Finding Lists begin on page ii.



The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and en-

force 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 and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

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

The adjusted applicable federal long-term rate is set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 904.—Limitation on Credit

26 CFR 1.904-0: Outline of regulation provisions for section 904.

T.D. 9521

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Reduction of Foreign Tax Credit Limitation Categories Under Section 904(d)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance relating to the reduction of the number of separate foreign tax credit limitation categories under section 904(d) of the Internal Revenue Code. Changes to the applicable law were made by the American Jobs Creation Act of 2004 (AJCA) reducing the number of section 904(d) separate categories from eight to two, effective for taxable years beginning after December 31, 2006. The final regulations provide guidance needed to comply with these changes and affect individuals and corporations claiming foreign tax credits.

DATES: *Effective Date:* These regulations are effective on April 7, 2011.

Applicability Dates: For dates of applicability, see §§1.904-2(i)(3), 1.904-4(n), 1.904-5(o)(3), 1.904-7(g)(6), and 1.904(f)-12(h)(6).

FOR FURTHER INFORMATION CONTACT: Jeffrey L. Parry, (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 21, 2007, a notice of proposed rulemaking by cross-reference to

temporary regulations (REG-114126-07, 2008-1 C.B. 410) under section 904 of the Code and temporary regulations (T.D. 9368, 2008-1 C.B. 382) (the 2007 temporary regulations) were published in the **Federal Register** (72 FR 72645) and (72 FR 72582), respectively. Corrections to those temporary regulations were published on March 21, 2008, in the **Federal Register** (73 FR 15063). No written comments were received. A public hearing was not requested and none was held. This Treasury decision adopts the proposed regulation with the changes discussed in this preamble.

Explanation of Changes in this Final Rule

I. Gain from the Sale of a Partnership Interest

Section 954(c)(4), which was enacted by the AJCA, provides a look-through rule for sales of 25-percent-owned partnerships. Because the definition of passive income in section 904(d)(2)(B) refers to section 954(c), §1.904-5T(h)(3)(ii) of the 2007 temporary regulations provides that in the case of a sale of a partnership interest by a 25-percent partner, under the principles of section 954(c)(4)(B) the income recognized on such sale is assigned to the separate category for general category income, to the extent that the gain would not be classified as foreign personal holding company income under the section 954(c)(4) look-through rule. The rule has been revised to clarify that the look-through rule applies to a sale by any 25-percent owner of a partnership (and not just controlled foreign corporations that are 25-percent partners). The language of this provision has also been revised to be more consistent with the language of the look-through rule as provided under section 954(c)(4).

II. Losses in and Losses with respect to the Pre-2007 Separate Category for High Withholding Tax Interest

Section 1.904(f)-12T(h) of the 2007 temporary regulations provides transition rules for recapture in a taxable year beginning after December 31, 2006 (post-2006 taxable year) of an overall foreign loss (OFL) or separate limitation loss (SLL)

in a pre-2007 separate category (as defined in §1.904-7T(g)(1)(ii)) that offset U.S. source income or income in another pre-2007 separate category, respectively. Section 1.904(f)-12T(h)(3) provides that to the extent a taxpayer had an OFL or SLL at the end of the taxpayer's last pre-2007 taxable year in the pre-2007 separate category for high withholding tax interest, the allocation of such OFL or SLL to the taxpayer's post-2006 separate categories follows the taxpayer's allocation of excess taxes in the high withholding tax interest loss category for section 904(c) carryover purposes. If there were no excess taxes in the loss category that carried over to post-2006 taxable years, an OFL or SLL in the pre-2007 separate category for high withholding tax interest is allocated to the post-2006 separate category for passive category income. Similarly, §1.904(f)-12T(h)(3) provides that where a taxpayer had an SLL in a pre-2007 separate category that offset high withholding tax interest (that is, an SLL with respect to a pre-2007 separate category for high withholding tax interest), the SLL will be recaptured in subsequent taxable years *pro rata* as income in the post-2006 separate categories for general category income and passive category income based on how the taxpayer allocated excess taxes in the pre-2007 separate category for high withholding tax interest. If no excess taxes in the pre-2007 separate category for high withholding tax interest were carried over to post-2006 taxable years, the SLL will be recaptured in subsequent taxable years as income in the post-2006 separate category for passive category income.

A question was raised as to whether it was appropriate, in the case of a financial services entity that had a loss in, or a loss with respect to, a pre-2007 separate category for high withholding tax interest, and no excess taxes in the loss category were carried over to post-2006 taxable years, that the loss be allocated to the post-2006 separate category for passive category income (in the case of a loss in the pre-2007 separate category for high withholding tax interest) or that the loss be recaptured in subsequent taxable years as income in the post-2006 separate category for passive category income (in the case of a loss with respect to a pre-2007 separate category for high withholding tax interest).

Section 904(d)(2)(C)(i), as amended by the AJCA, provides that financial services income is treated as general category income in the case of a member of a financial services group and any other person predominantly engaged in the active conduct of a banking, insurance, financing or similar business (a financial services entity). Financial services income includes passive income that is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, but does not include specified passive category income. See section 904(d)(2)(D)(i)(II). Accordingly, in post-2006 taxable years, income that otherwise would be treated as passive income (and assigned to the separate category for passive category income) will instead be treated as general category income in the case of a financial services entity.

The IRS and the Treasury Department believe that, in the case of a financial services entity, the appropriate treatment of a loss in, or a loss with respect to, a pre-2007 separate category for high withholding tax interest, where no excess taxes in the loss category were carried over to post-2006 taxable years, is to allocate the loss to the post-2006 separate category for general category income or to recapture the loss in subsequent years as general category income, as the case may be. Accordingly, the regulations have been revised to provide that if a financial services entity allocated under §1.904(f)-12T(h)(3) an OFL or SLL at the end of its last pre-2007 taxable year in the pre-2007 separate category for high withholding tax interest to the post-2006 separate category for passive category income, and no excess taxes in the loss category were carried over to post-2007 taxable years, the amount of any such loss that has not yet been recaptured will be allocated to the post-2006 separate category for general category income. Similarly, if a financial services entity allocated under §1.904(f)-12T(h)(3) at the end of its last pre-2007 taxable year an SLL with respect to a pre-2007 separate category for high withholding tax interest, and no excess taxes in the separate category for high withholding tax interest were carried over to post-2007 taxable years (that is, the SLL would be subject to recapture as passive category income), the amount of any such SLL that has not yet been recaptured

will be recaptured in subsequent taxable years as general category income.

III. Section 952(c) Recapture Accounts

Section 1.904-7(g)(3) of the final regulations clarifies that section 952(c)(2) recapture accounts maintained by a controlled foreign corporation with respect to subpart F income in a separate category that was subject to the earnings and profits limitation of section 952(c)(1)(A) are allocated to separate categories in the same manner as the associated post-1986 undistributed earnings.

IV. Safe Harbors

The 2007 temporary regulations provide several safe harbors that a taxpayer may apply in lieu of generally applicable rules. Section 1.904-2T(i)(1)(ii) provides a safe harbor for the carryover of unused foreign taxes in a pre-2007 separate category to a post-2006 separate category; §1.904-2T(i)(2)(ii) provides a safe harbor for the carryback of unused foreign taxes in a post-2006 separate category to a pre-2007 separate category; §1.904-7T(g)(3)(ii) provides safe harbors for allocating pools of post-1986 undistributed earnings and post-1986 foreign income taxes in the pre-2007 separate categories of controlled foreign corporations and noncontrolled section 902 corporations to the post-2006 separate categories; and §1.904(f)-12T(h)(5) provides an alternative method for determining the recapture in post-2006 taxable years of separate limitation losses and overall foreign losses incurred in pre-2007 taxable years.

A question was raised as to how a safe harbor method election is to be made and the time frame for making the election. The final regulations provide that taxpayers may choose to use a safe harbor method on a timely filed (original or amended) tax return or during audit. If a taxpayer chooses to use the safe harbor method on an amended return or in the course of an audit, the taxpayer must make appropriate adjustments to eliminate any double benefit arising from application of the safe harbor method to years that are not open for assessment. A taxpayer's choice to use the safe harbor method is evidenced by simply employing the method in determining

its foreign tax credit limitation. No separate statement need be filed.

V. Effective/Applicability Dates

The effective/applicability dates are the same as those in the proposed and temporary regulations with minor clarifying changes.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Drafting Information

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

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

Par. 2. Section 1.904-0 is amended by adding entries for §§1.904-2(i), 1.904-4(a), (b), (h)(3), and (l), 1.904-5(h)(3) and (o)(3), and 1.904-7(g) to read as follows:

§1.904-0 Outline of regulation provisions for section 904.

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§1.904-2 Carryback and carryover of unused foreign tax.

* * * * *

(i) Transition rules for carryovers and carrybacks of pre-2007 and post-2006 unused foreign tax.

- (1) Carryover of unused foreign tax.
 - (i) General rule.
 - (ii) Safe harbor.
- (2) Carryback of unused foreign tax.
 - (i) General rule.
 - (ii) Safe harbor.
- (3) Effective/applicability date.

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§1.904-4 Separate application of section 904 with respect to certain categories of income.

- (a) In general.
 - (b) Passive category income.
 - (1) In general.
 - (2) Passive income.
 - (i) In general.
 - (ii) Exceptions.
 - (iii) Active rents or royalties.
 - (A) In general.
 - (B) Active conduct of trade or business.
 - (iv) Examples.
 - (3) Specified passive category income.

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- (h) * * *
- (3) Exception.

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- (1) Priority rule.

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§1.904-5 Look-through rules as applied to controlled foreign corporations and other entities.

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- (h) * * *
- (3) Income from the sale of a partnership interest.
 - (i) In general.
 - (ii) Exception for sale by 25-percent owner.

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- (o) * * *
- (3) Rules for income from the sale of a partnership interest.

§1.904-7 Transition rules.

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(g) Treatment of earnings and foreign taxes of a controlled foreign corporation

or a noncontrolled section 902 corporation accumulated in taxable years beginning before January 1, 2007.

(1) Definitions.

(i) Pre-2007 pools.

(ii) Pre-2007 separate categories.

(iii) Post-2006 separate categories.

(2) Treatment of pre-2007 pools of a controlled foreign corporation or a noncontrolled section 902 corporation.

(3) Substantiation of post-2006 character of earnings and taxes in a pre-2007 pool.

(i) Reconstruction of earnings and taxes pools.

(ii) Safe harbor method.

(A) In general.

(B) General safe harbor method.

(C) Interest apportionment safe harbor.

(iii) Consistency rule.

(4) Treatment of pre-1987 accumulated profits.

(5) Treatment of earnings and foreign taxes in pre-2007 pools of a lower-tier controlled foreign corporation or noncontrolled section 902 corporation.

(6) Effective/applicability date.

Par. 3. Section 1.904-2(i) is revised to read as follows:

§1.904-2 Carryback and carryover of unused foreign tax.

* * * * *

(i) *Transition rules for carryovers and carrybacks of pre-2007 and post-2006 unused foreign tax*—(1) *Carryover of unused foreign tax*—(i) *General rule*. For purposes of this paragraph (i), the terms *post-2006 separate category* and *pre-2007 separate category* have the meanings set forth in §1.904-7(g)(1)(ii) and (iii). The rules of this paragraph (i)(1) apply to reallocate to the taxpayer's post-2006 separate categories for general category income and passive category income any unused foreign taxes (as defined in §1.904-2(b)(2)) that were paid or accrued or deemed paid under section 902 with respect to income in a pre-2007 separate category (other than a category described in §1.904-4(m)). To the extent any such unused foreign taxes are carried forward to a taxable year beginning after December 31, 2006, such taxes shall be allocated to the taxpayer's post-2006 separate categories to which those taxes would have been allocated if the taxes were paid or accrued in a taxable

year beginning after December 31, 2006. For example, any foreign taxes paid or accrued or deemed paid with respect to financial services income in a taxable year beginning before January 1, 2007, that are carried forward to a taxable year beginning after December 31, 2006, will be allocated to the general category because the financial services income to which those taxes relate would have been allocated to the general category if it had been earned in a taxable year beginning after December 31, 2006.

(ii) *Safe harbor*. In lieu of applying the rules of paragraph (i)(1)(i) of this section, a taxpayer may allocate all unused foreign taxes in the pre-2007 separate category for passive income to the post-2006 separate category for passive category income, and allocate all other unused foreign taxes described in paragraph (i)(1)(i) of this section to the post-2006 separate category for general category income. A taxpayer may choose to use the safe harbor method on a timely filed (original or amended) tax return or during an audit. A taxpayer that uses the safe harbor method on an amended return or in the course of an audit must make appropriate adjustments to eliminate any double benefit arising from application of the safe harbor method to years that are not open for assessment. A taxpayer's choice to use the safe harbor method is evidenced by employing the method. The taxpayer need not file any separate statement.

(2) *Carryback of unused foreign tax*—(i) *General rule*. The rules of this paragraph (i)(2) apply to any unused foreign taxes that were paid or accrued or deemed paid under section 902 with respect to income in a post-2006 separate category (other than a category described in §1.904-4(m)). To the extent any such unused foreign taxes are carried back to a taxable year beginning before January 1, 2007, a credit for such taxes shall be allowed only to the extent of the excess limitation in the pre-2007 separate category, or categories, to which the taxes would have been allocated if the taxes were paid or accrued in a taxable year beginning before January 1, 2007. For example, any foreign taxes paid or accrued or deemed paid with respect to income in the general category in a taxable year beginning after December 31, 2006, that are carried back to a taxable

year beginning before January 1, 2007, will be allocated to the same separate categories to which the income would have been allocated if such income had been earned in a taxable year beginning before January 1, 2007.

(ii) *Safe harbor*. In lieu of applying the rules of paragraph (i)(2)(i) of this section, a taxpayer may allocate all unused foreign taxes in the post-2006 separate category for passive category income to the pre-2007 separate category for passive income, and may allocate all other unused foreign taxes described in paragraph (i)(2)(i) of this section to the pre-2007 separate category for general limitation income. A taxpayer may choose to use the safe harbor method on a timely filed (original or amended) tax return or during an audit. A taxpayer that uses the safe harbor method on an amended return or in the course of an audit must make appropriate adjustments to eliminate any double benefit arising from application of the safe harbor method to years that are not open for assessment. A taxpayer's choice to use the safe harbor method is evidenced by employing the method. The taxpayer need not file any separate statement.

(3) *Effective/applicability date*. This paragraph (i) applies to taxable years beginning after December 31, 2006 and ending on or after December 21, 2007.

§1.904-2T [Removed].

Par. 4. Section 1.904-2T is removed.

Par. 5. In §1.904-4, paragraphs (a), (b), (h)(3), and (l) are revised, paragraphs (f) and (g) are removed and reserved, and a new sentence is added immediately after the heading of paragraph (n) to read as follows:

§1.904-4 Separate application of section 904 with respect to certain categories of income.

(a) *In general*. A taxpayer is required to compute a separate foreign tax credit limitation for income received or accrued in a taxable year that is described in section 904(d)(1)(A) (passive category income), 904(d)(1)(B) (general category income), or §1.904-4(m) (additional separate categories).

(b) *Passive category income*—(1) *In general*. The term *passive category in-*

come means passive income and specified passive category income.

(2) *Passive income*—(i) *In general*. The term *passive income* means any—

(A) Income received or accrued by any person that is of a kind that would be foreign personal holding company income (as defined in section 954(c)) if the taxpayer were a controlled foreign corporation, including any amount of gain on the sale or exchange of stock in excess of the amount treated as a dividend under section 1248; or

(B) Amount includible in gross income under section 1293.

(ii) *Exceptions*. Passive income does not include any export financing interest (as defined in section 904(d)(2)(G) and paragraph (h) of this section), any high-taxed income (as defined in section 904(d)(2)(F) and paragraph (c) of this section), or any active rents and royalties (as defined in paragraph (b)(2)(iii) of this section). In addition, passive income does not include any income that would otherwise be passive but is characterized as income in another separate category under the look-through rules of section 904(d)(3), (d)(4), and (d)(6)(C) and the regulations under those provisions. In determining whether any income is of a kind that would be foreign personal holding company income, the rules of section 864(d)(5)(A)(i) and (6) (treating related person factoring income of a controlled foreign corporation as foreign personal holding company income that is not eligible for the export financing income exception to the separate limitation for passive income) shall apply only in the case of income of a controlled foreign corporation (as defined in section 957). Thus, income earned directly by a United States person that is related person factoring income may be eligible for the exception for export financing interest.

(iii) *Active rents or royalties*—(A) *In general*. For rents and royalties paid or accrued after September 20, 2004, passive income does not include any rents or royalties that are derived in the active conduct of a trade or business, regardless of whether such rents or royalties are received from a related or an unrelated person. Except as provided in paragraph (b)(2)(iii)(B) of this section, the principles of section 954(c)(2)(A) and the regulations under that section shall apply in determining whether rents or royalties are derived

in the active conduct of a trade or business. For this purpose, the term taxpayer shall be substituted for the term controlled foreign corporation if the recipient of the rents or royalties is not a controlled foreign corporation.

(B) *Active conduct of trade or business*. Rents and royalties are considered derived in the active conduct of a trade or business by a United States person or by a controlled foreign corporation (or other entity to which the look-through rules apply) for purposes of section 904 (but not for purposes of section 954) if the requirements of section 954(c)(2)(A) are satisfied by one or more corporations that are members of an affiliated group of corporations (within the meaning of section 1504(a), determined without regard to section 1504(b)(3)) of which the recipient is a member. For purposes of this paragraph (b)(2)(iii)(B), an affiliated group includes only domestic corporations and foreign corporations that are controlled foreign corporations in which domestic members of the affiliated group own, directly or indirectly, at least 80 percent of the total voting power and value of the stock. For purposes of this paragraph (b)(2)(iii)(B), indirect ownership shall be determined under section 318 and the regulations under that section.

(iv) *Examples*. The following examples illustrate the application of paragraph (b)(2) of this section.

Example 1. P is a domestic corporation with a branch in foreign country X. P does not have any financial services income. For 2008, P has a net foreign currency gain that would not constitute foreign personal holding company income if P were a controlled foreign corporation because the gain is directly related to the business needs of P. The currency gain is, therefore, general category income to P because it is not income of a kind that would be foreign personal holding company income.

Example 2. Controlled foreign corporation S is a wholly-owned subsidiary of P, a domestic corporation. S is regularly engaged in the restaurant franchise business. P licenses trademarks, tradenames, certain know-how, related services, and certain restaurant designs for which S pays P an arm's length royalty. P is regularly engaged in the development and licensing of such property. The royalties received by P for the use of its property are allocable under the look-through rules of §1.904-5 to the royalties S receives from the franchisees. Some of the franchisees are unrelated to S and P. Other franchisees are related to S or P and use the licensed property outside of S's country of incorporation. S does not satisfy, but P does satisfy, the active trade or business requirements of section 954(c)(2)(A) and the regulations under that section. The royalty income earned by S with regard

to both its related and unrelated franchisees is foreign personal holding company income because S does not satisfy the active trade or business requirements of section 954(c)(2)(A) and, in addition, the royalty income from the related franchisees does not qualify for the same country exception of section 954(c)(3). However, all of the royalty income earned by S is general category income to S under §1.904-4(b)(2)(iii) because P, a member of S's affiliated group (as defined therein), satisfies the active trade or business test (which is applied without regard to whether the royalties are paid by a related person). S's royalty income that is taxable to P under subpart F and the royalties paid to P are general category income to P under the look-through rules of §1.904-5(c)(1)(i) and (c)(3), respectively.

(3) *Specified passive category income* means—

(i) Dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States;

(ii) Taxable income attributable to foreign trade income (within the meaning of section 923(b)); or

(iii) Distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)).

* * * * *

(f) [Reserved].

(g) [Reserved].

(h) * * *

(3) *Exception*. Unless it is received or accrued by a financial services entity, export financing interest shall be treated as passive category income if that income is also related person factoring income. For this purpose, related person factoring income is—

(i) Income received or accrued by a controlled foreign corporation that is income described in section 864(d)(6) (income of a controlled foreign corporation from a loan for the purpose of financing the purchase of inventory property of a related person); or

(ii) Income received or accrued by any person that is income described in section 864(d)(1) (income from a trade receivable acquired from a related person).

* * * * *

(1) *Priority rule*. Income that meets the definitions of a separate category de-

scribed in paragraph (m) of this section and another category of income described in section 904(d)(2)(A)(i) and (ii) will be subject to the separate limitation described in paragraph (m) of this section and will not be treated as general category income described in section 904(d)(2)(A)(ii).

* * * * *

(n) * * * Paragraphs (a), (b), (h)(3), and (l) of this section shall apply to taxable years of United States persons and, for purposes of section 906, foreign persons beginning after December 31, 2006 and ending on or after December 21, 2007, and to taxable years of a foreign corporation which end with or within taxable years of its domestic corporate shareholder beginning after December 31, 2006 and ending on or after December 21, 2007. * * *

§1.904-4T [Removed].

Par. 6. Section 1.904-4T is removed.

Par. 7. In §1.904-5, paragraphs (h)(3) and (o)(3) are revised to read as follows:

§1.904-5 Look-through rules as applied to controlled foreign corporations and other entities.

* * * * *

(h) * * *

(3) *Income from the sale of a partnership interest*—(i) *In general.* To the extent a partner recognizes gain on the sale of a partnership interest, that income shall be treated as passive category income to the partner, unless the income is considered to be high-taxed under section 904(d)(2)(B)(iii)(II) and §1.904-4(c).

(ii) *Exception for sale by 25-percent owner.* In the case of a sale of an interest in a partnership by a partner that is a 25-percent owner of the partnership, determined by applying section 954(c)(4)(B) and substituting “controlled foreign corporation” with “partner” every place it appears, for purposes of determining the separate category to which the income recognized on the sale of the partnership interest is assigned such partner shall be treated as selling the proportionate share of the assets of the partnership attributable to such interest.

* * * * *

(o) * * *

(3) *Rules for income from the sale of a partnership interest.* Paragraph (h)(3) of

this section shall apply to taxable years of United States persons and, for purposes of section 906, foreign persons beginning after December 31, 2006 and ending on or after December 21, 2007, and to taxable years of a foreign corporation which end with or within taxable years of its domestic corporate shareholder beginning after December 31, 2006 and ending on or after December 21, 2007.

§1.904-5T [Removed].

Par. 8. Section 1.904-5T is removed.

Par. 9. Section 1.904-7, paragraph (g) is revised to read as follows:

§1.904-7 Transition rules.

* * * * *

(g) *Treatment of earnings and foreign taxes of a controlled foreign corporation or a noncontrolled section 902 corporation accumulated in taxable years beginning before January 1, 2007*—(1) *Definitions*—(i) *Pre-2007 pools* means the pools in each separate category of post-1986 undistributed earnings (as defined in §1.902-1(a)(9)) that were accumulated, and post-1986 foreign income taxes (as defined in §1.902-1(a)(8)) paid, accrued, or deemed paid, in taxable years beginning before January 1, 2007.

(ii) *Pre-2007 separate categories* means the separate categories of income described in section 904(d) as applicable to taxable years beginning before January 1, 2007, and any other separate category of income described in §1.904-4(m).

(iii) *Post-2006 separate categories* means the separate categories of income described in section 904(d) as applicable to taxable years beginning after December 31, 2006, and any other separate category of income described in §1.904-4(m).

(2) *Treatment of pre-2007 pools of a controlled foreign corporation or a noncontrolled section 902 corporation.* Any post-1986 undistributed earnings in a pre-2007 pool of a controlled foreign corporation or a noncontrolled section 902 corporation shall be treated in taxable years beginning after December 31, 2006, as if they were accumulated during a period in which the rules governing the determination of post-2006 separate categories applied. Post-1986 foreign income

taxes paid, accrued, or deemed paid with respect to such earnings shall be treated as if they were paid, accrued, or deemed paid during a period in which the rules governing the determination of post-2006 separate categories (including the rules of section 904(d)(3)(E)) applied as well. Any such earnings and taxes in pre-2007 pools shall constitute the opening balance of the foreign corporation’s post-1986 undistributed earnings and post-1986 foreign income taxes on the first day of the foreign corporation’s first taxable year beginning after December 31, 2006, in accordance with the rules of paragraph (g)(3) of this section. Similar rules shall apply to characterize any deficits in the pre-2007 pools and previously-taxed earnings and profits described in section 959(c)(1) and (2) that are attributable to earnings in the pre-2007 pools. Any section 952(c)(2) recapture account with respect to a separate category shall be allocated in the same manner as the post-1986 undistributed earnings in the associated pre-2007 pool.

(3) *Substantiation of post-2006 character of earnings and taxes in a pre-2007 pool*—(i) *Reconstruction of earnings and taxes pools.* In order to substantiate the post-2006 characterization of post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes in pre-2007 pools of a controlled foreign corporation or a noncontrolled section 902 corporation, the taxpayer shall make a reasonable, good-faith effort to reconstruct the pre-2007 pools of post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes following the rules governing the determination of post-2006 separate categories for each taxable year beginning before January 1, 2007, beginning with the first year in which post-1986 undistributed earnings were accumulated in the pre-2007 pool. Reconstruction shall be based on reasonably available books and records and other relevant information. To the extent any pre-2007 separate category includes earnings that would be allocated to more than one post-2006 separate category, the taxpayer must account for earnings distributed and taxes deemed paid in these years for such category as if they were distributed and deemed paid *pro rata* from the amounts that were added

to that category during each taxable year beginning before January 1, 2007.

(ii) *Safe harbor method*—(A) *In general*. Subject to the rules of paragraph (g)(3)(iii) of this section, a taxpayer may allocate the post-1986 undistributed earnings and post-1986 foreign income taxes in pre-2007 pools of a controlled foreign corporation or a noncontrolled section 902 corporation (as well as deficits and previously-taxed earnings, if any) under one of the safe harbor methods described in paragraphs (g)(3)(ii)(B) and (g)(3)(ii)(C) of this section. A taxpayer may choose to use the safe harbor method on a timely filed (original or amended) tax return or during an audit. A taxpayer that uses the safe harbor method on an amended return or in the course of an audit must make appropriate adjustments to eliminate any double benefit arising from application of the safe harbor method to years that are not open for assessment. A taxpayer's choice to use the safe harbor method is evidenced by employing the method. The taxpayer need not file any separate statement.

(B) *General safe harbor method*—(1) Any post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes of a noncontrolled section 902 corporation or a controlled foreign corporation in a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income, or certain distributions from a FSC or former FSC shall be allocated to the post-2006 separate category for passive category income.

(2) Any post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes of a noncontrolled section 902 corporation or a controlled foreign corporation in a pre-2007 separate category for financial services income, shipping income or general limitation income shall be allocated to the post-2006 separate category for general category income.

(3) Except as provided in paragraph (g)(3)(ii)(B)(4) of this section, any post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes of a noncontrolled section 902 corporation or a controlled foreign corporation in a pre-2007 separate category for high with-

holding tax interest shall be allocated to the post-2006 separate category for passive category income.

(4) If a controlled foreign corporation has positive post-1986 undistributed earnings and post-1986 foreign income taxes in a pre-2007 separate category for high withholding tax interest, such earnings and taxes shall be allocated to the post-2006 separate category for general category income if the earnings would qualify as income subject to high foreign taxes under section 954(b)(4) if the entire amount of post-1986 undistributed earnings were treated as a net item of income subject to the rules of §1.954-1(d). If the high withholding tax interest earnings would not qualify as income subject to high foreign taxes under section 954(b)(4), then the earnings and taxes shall be allocated to the post-2006 separate category for passive category income.

(C) *Interest apportionment safe harbor*. A taxpayer may allocate the post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes in pre-2007 pools of a controlled foreign corporation or a noncontrolled section 902 corporation following the principles of paragraph (f)(4)(ii) of this section.

(iii) *Consistency rule*. The election to apply a safe harbor method under paragraph (g)(3)(ii) of this section in lieu of the rules described in paragraph (g)(3)(i) of this section may be made on a separate category by separate category basis. However, if a taxpayer elects to apply a safe harbor to allocate pre-2007 pools of more than one pre-2007 separate category of a controlled foreign corporation or a noncontrolled section 902 corporation, such safe harbor (the general safe harbor described in paragraph (g)(3)(ii)(B) of this section or the interest apportionment safe harbor described in paragraph (g)(3)(ii)(C) of this section) shall apply to allocate post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes for the pre-2007 pools in each pre-2007 separate category of the foreign corporation for which the taxpayer elected to apply a safe harbor method in lieu of reconstructing the pre-2007 pools.

(4) *Treatment of pre-1987 accumulated profits*. Any pre-1987 accumulated profits (as defined in §1.902-1(a)(10)) of a

noncontrolled section 902 corporation or a controlled foreign corporation shall be treated in taxable years beginning after December 31, 2006, as if they had been accumulated during a period in which the rules governing the determination of post-2006 separate categories applied. Foreign income taxes paid, accrued, or deemed paid with respect to such earnings shall be treated as if they were paid, accrued, or deemed paid during a period in which the rules governing the determination of post-2006 separate categories applied as well. The taxpayer must substantiate the post-2006 characterization of the pre-1987 accumulated profits and pre-1987 foreign income taxes in accordance with the rules of paragraph (g)(3) of this section, including the safe harbor provisions. Similar rules shall apply to characterize any deficits or previously-taxed earnings and profits described in section 959(c)(1) and (2) that are attributable to pre-1987 accumulated profits.

(5) *Treatment of earnings and foreign taxes in pre-2007 pools of a lower-tier controlled foreign corporation or noncontrolled section 902 corporation*. The rules of paragraphs (g)(1) through (4) of this section apply to post-1986 undistributed earnings (as well as deficits and previously-taxed earnings, if any) and post-1986 foreign income taxes in pre-2007 pools, and pre-1987 accumulated profits and pre-1987 foreign income taxes, of a lower-tier controlled foreign corporation or noncontrolled section 902 corporation.

(6) *Effective/applicability date*. This paragraph (g) shall apply to taxable years of United States persons and, for purposes of section 906, foreign persons beginning after December 31, 2006 and ending on or after December 21, 2007, and to taxable years of a foreign corporation which end with or within taxable years of its domestic corporate shareholder beginning after December 31, 2006 and ending on or after December 21, 2007.

§1.904-7T [Removed].

Par. 10. Section 1.904-7T is removed.

Par. 11. Section 1.904(f)-0 is amended by adding an entry for §1.904(f)-12(h) to read as follows:

§1.904(f)-0 Outline of regulation provisions.

§1.904(f)-12 Transition rules.

(h) Recapture in years beginning after December 31, 2006, of separate limitation losses and overall foreign losses incurred in years beginning before January 1, 2007.

(1) Losses related to pre-2007 separate categories for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.

(i) Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.

(ii) Recapture of separate limitation loss with respect to a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.

(2) Losses related to pre-2007 separate categories for shipping, financial services income or general limitation income.

(i) Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for shipping income, financial services income or general limitation income.

(ii) Recapture of separate limitation loss with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income.

(3) Losses related to a pre-2007 separate category for high withholding tax interest.

(i) Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for high withholding tax interest.

(ii) Recapture of separate limitation loss with respect to a pre-2007 separate category for high withholding tax interest.

(4) Elimination of certain separate limitation loss accounts.

(5) Alternative method.

(6) Effective/applicability date.

Par. 12. Section 1.904(f)-12(h) is revised to read as follows:

§1.904(f)-12 Transition rules.

(h) Recapture in years beginning after December 31, 2006, of separate limitation losses and overall foreign losses incurred in years beginning before January 1, 2007—

(1) Losses related to pre-2007 separate categories for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC—

(i) Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.

To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category (as defined in §1.904-7(g)(1)(ii)) for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC, at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance, or balances, shall be allocated on the first day of the taxpayer's next taxable year to the taxpayer's post-2006 separate category (as defined in §1.904-7(g)(1)(iii)) for passive category income.

(ii) Recapture of separate limitation loss with respect to a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.

To the extent that a taxpayer has a balance in any separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years as income in the post-2006

separate category for passive category income.

(2) Losses related to pre-2007 separate categories for shipping, financial services income or general limitation income—

(i) Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for shipping income, financial services income or general limitation income. To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category for shipping income, financial services income or general limitation income at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance, or balances, shall be allocated on the first day of the taxpayer's next taxable year to the taxpayer's post-2006 separate category for general category income.

(ii) Recapture of separate limitation loss with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income. To the extent that a taxpayer has a balance in any separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years as income in the post-2006 separate category for general category income.

(3) Losses related to a pre-2007 separate category for high withholding tax interest—

(i) Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for high withholding tax interest. To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category for high withholding tax interest at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance shall be allocated on the first day of the taxpayer's next taxable year on a *pro rata* basis to the taxpayer's post-2006 separate categories for general category and passive category income, based on the proportion in which any unused foreign taxes in the same pre-2007 separate category for high withholding tax interest are allocated under §1.904-2(i)(1). If the tax-

payer, other than a financial services entity as defined in §1.904-4(e)(3), has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then any loss account balance in that category shall be allocated to the post-2006 separate category for passive category income. If the taxpayer is a financial services entity, as defined in §1.904-4(e)(3), and has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then any loss account balance in that category shall be allocated to the post-2006 separate category for general category income.

(ii) *Recapture of separate limitation loss with respect to a pre-2007 separate category for high withholding tax interest.* To the extent that a taxpayer has a balance in a separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for high withholding tax interest at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years on a *pro rata* basis as income in the post-2006 separate categories for general category and passive category income, based on the proportion in which any unused foreign taxes in the pre-2007 separate category for high withholding tax interest are allocated under §1.904-2(i)(1). If the taxpayer, other than a financial services entity as defined in §1.904-4(e)(3), has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then the loss account balance shall be recaptured in subsequent taxable years solely as income in the post-2006 separate category for passive category income. If the taxpayer is a financial services entity, as defined in §1.904-4(e)(3), and has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then the loss account balance shall be recaptured in subsequent taxable years solely as income in the post-2006 separate category for general category income.

(4) *Elimination of certain separate limitation loss accounts.* After application of paragraphs (h)(1) through (h)(3) of this section, any separate limitation loss account allocated to the post-2006 separate category for passive category income for which income is to be recaptured as passive category income, as determined under those same provisions, shall be elimi-

nated. Similarly, after application of paragraphs (h)(1) through (h)(3) of this section, any separate limitation loss account allocated to the post-2006 separate category for general category income for which income is to be recaptured as general category income, as determined under those same provisions, shall be eliminated.

(5) *Alternative method.* In lieu of applying the rules of paragraphs (h)(1) through (h)(3) of this section, a taxpayer may apply the principles of paragraphs (g)(1) and (g)(2) of this section to determine recapture in taxable years beginning after December 31, 2006, of separate limitation losses and overall foreign losses incurred in taxable years beginning before January 1, 2007. A taxpayer may choose to use the alternative method on a timely filed (original or amended) tax return or during an audit. A taxpayer that uses the alternative method on an amended return or in the course of an audit must make appropriate adjustments to eliminate any double benefit arising from application of the alternative method to years that are not open for assessment. A taxpayer's choice to use the alternative method is evidenced by employing the method. The taxpayer need not file any separate statement.

(6) *Effective/applicability date.* This paragraph (h) shall apply to taxable years beginning after December 31, 2006, and ending on or after December 21, 2007. However, taxpayers may choose to apply 26 CFR 1.904(f)-12T(h) as it appeared in the Code of Federal Regulations as of April 1, 2010, in lieu of this paragraph (h) to taxable years beginning after December 31, 2006 and ending on or after December 21, 2007, but ending before April 7, 2011 provided that appropriate adjustments are made to eliminate duplicate benefits arising from application of 26 CFR 1.904(f)-12T(h) to taxable years that are not open for assessment. In addition, if a taxpayer that is a financial services entity (as defined in §1.904-4(e)(3)) chooses to apply 26 CFR 1.904(f)-12T(h) to taxable years ending before April 7, 2011, then as of the beginning of the taxpayer's first taxable year ending on or after April 7, 2011 any remaining balance in a passive category loss account that is attributable to a loss account in a pre-2007 separate category for high withholding tax interest shall be allocated

to the general category or eliminated pursuant to §1.904(f)-12(h)(4), and any remaining balance in a separate limitation loss account with respect to passive category income that is attributable to a loss account with respect to a pre-2007 separate category for high withholding tax interest will be recaptured in such year and subsequent taxable years as general category income or eliminated pursuant to §1.904(f)-12(h)(4).

§1.904(f)-12T [Removed].

Par. 13. Section 1.904(f)-12T is removed.

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

Approved March 29, 2011.

Michael Mundaca,
*Assistant Secretary of
the Treasury (Tax Policy).*

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for May 2011.

Rev. Rul. 2011-11

This revenue ruling provides various prescribed rates for federal income tax purposes for May 2011 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term

tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under

section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present

value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2011-11 TABLE 1				
Applicable Federal Rates (AFR) for May 2011				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-term</i>				
AFR	.56%	.56%	.56%	.56%
110% AFR	.62%	.62%	.62%	.62%
120% AFR	.67%	.67%	.67%	.67%
130% AFR	.73%	.73%	.73%	.73%
<i>Mid-term</i>				
AFR	2.44%	2.43%	2.42%	2.42%
110% AFR	2.69%	2.67%	2.66%	2.66%
120% AFR	2.94%	2.92%	2.91%	2.90%
130% AFR	3.18%	3.16%	3.15%	3.14%
150% AFR	3.68%	3.65%	3.63%	3.62%
175% AFR	4.30%	4.25%	4.23%	4.21%
<i>Long-term</i>				
AFR	4.19%	4.15%	4.13%	4.11%
110% AFR	4.62%	4.57%	4.54%	4.53%
120% AFR	5.04%	4.98%	4.95%	4.93%
130% AFR	5.47%	5.40%	5.36%	5.34%

REV. RUL. 2011-11 TABLE 2				
Adjusted AFR for May 2011				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	.73%	.73%	.73%	.73%
Mid-term adjusted AFR	1.98%	1.97%	1.97%	1.96%
Long-term adjusted AFR	4.30%	4.25%	4.23%	4.21%

REV. RUL. 2011-11 TABLE 3	
Rates Under Section 382 for May 2011	
Adjusted federal long-term rate for the current month	4.30%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.55%

REV. RUL. 2011-11 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for May 2011

Note: Under Section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, and before December 31, 2013, shall not be less than 9%.

Appropriate percentage for the 70% present value low-income housing credit	7.77%
Appropriate percentage for the 30% present value low-income housing credit	3.33%

REV. RUL. 2011-11 TABLE 5

Rate Under Section 7520 for May 2011

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	3.0%
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Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 2011. See Rev. Rul. 2011-11, page 758.

Part III. Administrative, Procedural, and Miscellaneous

Treasury Inflation-Protected Securities Issued at a Premium

Notice 2011-21

This notice provides guidance on the tax treatment of Treasury Inflation-Protected Securities (“TIPS”) issued at a premium. TIPS are securities issued by the Department of the Treasury. The principal amount of a TIPS is adjusted for any inflation or deflation that occurs over the term of the security. The rules for the taxation of TIPS (and other inflation-indexed debt instruments) are contained in § 1.1275-7 of the Income Tax Regulations. See also § 1.171-3(b) (rules for TIPS with bond premium). To date, the coupon bond method described in § 1.1275-7(d) has applied to TIPS rather than the more complex discount bond method described in § 1.1275-7(e).

Under the existing regulations, the coupon bond method is not available with respect to inflation-indexed debt instruments that are issued with more than a *de minimis* amount of premium. Section 1.1275-7(d)(2)(i). Due to recent financial conditions, however, the Department of the Treasury anticipates that TIPS may be issued at a premium that is more than a *de minimis* amount as determined under the principles of § 1.1273-1(d) (that is, an amount greater than .0025 times the stated principal amount of the security times the number of complete years to the security’s maturity).

To provide a more uniform method for the federal income taxation of TIPS, the Internal Revenue Service and the Department of the Treasury plan to issue regulations that will provide that taxpayers must apply the coupon bond method described in § 1.1275-7(d) with respect to TIPS issued with more than a *de minimis* amount of premium. As a result, the discount bond method described in § 1.1275-7(e) will not apply to TIPS issued with more than a *de minimis* amount of premium. The regulations will be effective for TIPS issued on or after April 8, 2011.

EXAMPLE

The following example illustrates the application of the coupon bond method to TIPS issued at a pre-

mium on or after the effective date of the change to § 1.1275-7 as described in this notice:

(i) *Facts.* X, a calendar year taxpayer, purchases at original issuance TIPS with a stated principal amount of \$100,000 and a stated interest rate of .125 percent, compounded semiannually. For purposes of this example, assume that the TIPS are issued in Year 1 on January 1, stated interest is payable on June 30 and December 31 of each year, and that the TIPS mature on December 31, Year 5. X pays \$102,000 for the TIPS, which is the issue price for the TIPS as determined under § 1.1275-2(d)(1). Assume that the inflation-adjusted principal amount for the first coupon in Year 1 is \$101,225 (resulting in an interest payment of \$63.27) and for the second coupon in Year 1 is \$102,500 (resulting in an interest payment of \$64.06). X elects to amortize bond premium under § 1.171-4. (For simplicity, contrary to actual practice, the TIPS in this example were issued on the date with respect to which the calculation of the first coupon began.)

(ii) *Bond premium.* The stated interest on the TIPS is qualified stated interest under § 1.1273-1(c). X acquired the TIPS with bond premium of \$2,000 (basis of \$102,000 minus the TIPS’ stated principal amount of \$100,000). See §§ 1.171-1(d), 1.171-3(b), and 1.1275-7(f)(3). The \$2,000 is more than the *de minimis* amount of premium for the TIPS of \$1,250 (.0025 times the stated principal amount of the TIPS (\$100,000) times the number of complete years to the TIPS’ maturity (5 years)). Although the TIPS were issued with more than a *de minimis* amount of bond premium, X must use the coupon bond method to determine X’s income from the TIPS.

(iii) *Allocation of bond premium.* Under § 1.171-3(b), the bond premium of \$2,000 is allocable to each semiannual accrual period by assuming that there will be no inflation or deflation over the term of the TIPS. Moreover, for purposes of § 1.171-2, the yield of the securities is determined by assuming that there will be no inflation or deflation over their term. Based on this assumption, for purposes of section 171, the TIPS provide for semiannual interest payments of \$62.50 and a \$100,000 payment at maturity. As a result, the yield of the securities for purposes of section 171 is -0.2720 percent, compounded semiannually. Under § 1.171-2, the bond premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period (\$62.50 for each accrual period) over the product of the taxpayer’s adjusted acquisition price at the beginning of the accrual period (determined without regard to any inflation or deflation) and the taxpayer’s yield. Therefore, the \$2,000 of bond premium is allocable to each semiannual accrual period in Year 1 as follows: \$201.22 to the accrual period ending on June 30, Year 1 (the excess of the stated interest of \$62.50 over $(\$102,000 \times -0.002720/2)$); and \$200.95 to the accrual period ending on December 31, Year 1 (the excess of the stated interest of \$62.50 over $(\$101,798.78 \times -0.002720/2)$).

(iv) *Income determined by applying the coupon bond method and the bond premium rules.* Under § 1.1275-7(d)(4), the application of the coupon bond

method to the TIPS results in a positive inflation adjustment in Year 1 of \$2,500, which is includible in X’s income for Year 1. However, because X acquired the TIPS at a premium and elected to amortize the premium, the premium allocable to Year 1 will offset the income on the TIPS as follows: The premium allocable to the first accrual period of \$201.22 first offsets the interest payable for that period of \$63.27. The remaining \$137.95 of premium is treated as a deflation adjustment that offsets the positive inflation adjustment. See § 1.171-3(b). The premium allocable to the second accrual period of \$200.95 first offsets the interest payable for that period of \$64.06. The remaining \$136.89 of premium is treated as a deflation adjustment that offsets the remaining positive inflation adjustment. As a result, X does not include in income any of the stated interest received in Year 1 and includes in Year 1 income only \$2,225.16 of the positive inflation adjustment for Year 1 ($\$2,500 - \$137.94 - \$136.89$).

DRAFTING INFORMATION

The principal author of this notice is William E. Blanchard of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Blanchard at (202) 622-3950 (not a toll-free call).

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2011-33

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code as in effect for plan years beginning before 2008. It also provides guidance on the corporate bond monthly yield curve (and the corresponding spot segment rates), and the 24-month average segment rates under § 430(h)(2). In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008, the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I), and the minimum present value segment rates under § 417(e)(3)(D) as in effect for plan years beginning after 2007.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004 and by the Pension Protection Act of 2006 (PPA), provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 through 2007 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conser-

vatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004-34, 2004-1 C.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices. The methodology for determining

the monthly composite corporate bond rate as set forth in Notice 2004-34 continues to apply in determining that rate. See Notice 2006-75, 2006-2 C.B. 366.

The composite corporate bond rate for March 2011 is 5.60 percent. Pursuant to Notice 2004-34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in		Corporate Bond Weighted Average	Permissible Range	
Month	Year		90%	100%
April	2011	6.06	5.45	6.06

YIELD CURVE AND SEGMENT RATES

Generally for plan years beginning after 2007 (except for delayed effective dates for certain plans under sections 104, 105, and 106 of PPA), § 430 of the Code specifies the minimum funding requirements that apply to single employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates

("segment rates"), each of which applies to cash flows during specified periods. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. Section 430(h)(2)(G) set forth a transitional rule applicable to plan years beginning in 2008 and 2009 under which the segment rates were blended with the corporate bond weighted average described above, including an election under § 430(h)(2)(G)(iv) for an employer to use the segment rates without the transitional rule.

Notice 2007-81, 2007-2 C.B. 899, provides guidelines for determining the

monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Pursuant to Notice 2007-81, the monthly corporate bond yield curve derived from March 2011 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of March 2011 are, respectively, 1.91, 5.23, and 6.46. The three 24-month average corporate bond segment rates applicable for April 2011 are as follows:

First Segment	Second Segment	Third Segment
2.51	5.59	6.38

The transitional rule of § 430(h)(2)(G) does not apply to plan years beginning after December 31, 2009. Therefore, for a plan year beginning after 2009 with a look-back month to April 2011, the funding segment rates are the three 24-month average corporate bond segment rates applicable for April 2011, listed above without blending for any transitional period.

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 417(e)(3)(A)(ii)(II) (prior to amendment by PPA) defines the appli-

cable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)-1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual rate of interest on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices

or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury securities for March 2011 is 4.51 percent. The Service has determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in February 2041.

Generally for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in section 431(c)(6)(A), based

on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent

below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88-73, 1988-2 C.B. 383, provides

guidelines for determining the weighted average interest rate. The following rates were determined for plan years beginning in the month shown below.

For Plan Years Beginning in		30-Year Treasury Weighted Average	Permissible Range	
<i>Month</i>	<i>Year</i>		90%	to 105%
April	2011	4.28	3.86	4.50

MINIMUM PRESENT VALUE SEGMENT RATES

Generally for plan years beginning after December 31, 2007, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a

24-month average. For plan years beginning in 2008 through 2011, the applicable interest rates are the monthly spot segment rates blended with the applicable rate under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning in 2007. Notice 2007-81 provides guidelines for determin-

ing the minimum present value segment rates. Pursuant to that notice, the minimum present value transitional segment rates determined for March 2011, taking into account the March 2011 30-year Treasury rate of 4.51 stated above, are as follows:

For Plan Years Beginning in	First Segment	Second Segment	Third Segment
2010	2.95	4.94	5.68
2011	2.43	5.09	6.07

DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans,

Tax Exempt and Government Entities Division. Mr. Montanaro may be e-mailed at RetirementPlanQuestions@irs.gov.

Table I
 Monthly Yield Curve for March 2011
 Derived from March 2011 Data

<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>	<i>Maturity</i>	<i>Yield</i>
0.5	0.46	20.5	6.05	40.5	6.51	60.5	6.67	80.5	6.75
1.0	0.76	21.0	6.07	41.0	6.52	61.0	6.67	81.0	6.75
1.5	1.07	21.5	6.09	41.5	6.52	61.5	6.67	81.5	6.75
2.0	1.39	22.0	6.11	42.0	6.53	62.0	6.68	82.0	6.75
2.5	1.74	22.5	6.13	42.5	6.53	62.5	6.68	82.5	6.75
3.0	2.09	23.0	6.15	43.0	6.54	63.0	6.68	83.0	6.76
3.5	2.43	23.5	6.17	43.5	6.54	63.5	6.68	83.5	6.76
4.0	2.75	24.0	6.18	44.0	6.55	64.0	6.69	84.0	6.76
4.5	3.05	24.5	6.20	44.5	6.55	64.5	6.69	84.5	6.76
5.0	3.33	25.0	6.21	45.0	6.56	65.0	6.69	85.0	6.76
5.5	3.58	25.5	6.23	45.5	6.56	65.5	6.69	85.5	6.76
6.0	3.80	26.0	6.24	46.0	6.57	66.0	6.70	86.0	6.76
6.5	4.01	26.5	6.26	46.5	6.57	66.5	6.70	86.5	6.77
7.0	4.19	27.0	6.27	47.0	6.58	67.0	6.70	87.0	6.77
7.5	4.36	27.5	6.28	47.5	6.58	67.5	6.70	87.5	6.77
8.0	4.51	28.0	6.30	48.0	6.59	68.0	6.70	88.0	6.77
8.5	4.65	28.5	6.31	48.5	6.59	68.5	6.71	88.5	6.77
9.0	4.78	29.0	6.32	49.0	6.59	69.0	6.71	89.0	6.77
9.5	4.90	29.5	6.33	49.5	6.60	69.5	6.71	89.5	6.77
10.0	5.00	30.0	6.34	50.0	6.60	70.0	6.71	90.0	6.77
10.5	5.10	30.5	6.35	50.5	6.61	70.5	6.71	90.5	6.78
11.0	5.19	31.0	6.36	51.0	6.61	71.0	6.72	91.0	6.78
11.5	5.27	31.5	6.37	51.5	6.61	71.5	6.72	91.5	6.78
12.0	5.35	32.0	6.38	52.0	6.62	72.0	6.72	92.0	6.78
12.5	5.42	32.5	6.39	52.5	6.62	72.5	6.72	92.5	6.78
13.0	5.49	33.0	6.40	53.0	6.62	73.0	6.72	93.0	6.78
13.5	5.55	33.5	6.41	53.5	6.63	73.5	6.73	93.5	6.78
14.0	5.60	34.0	6.42	54.0	6.63	74.0	6.73	94.0	6.78
14.5	5.65	34.5	6.43	54.5	6.63	74.5	6.73	94.5	6.78
15.0	5.70	35.0	6.44	55.0	6.64	75.0	6.73	95.0	6.79
15.5	5.74	35.5	6.44	55.5	6.64	75.5	6.73	95.5	6.79
16.0	5.78	36.0	6.45	56.0	6.64	76.0	6.73	96.0	6.79
16.5	5.82	36.5	6.46	56.5	6.65	76.5	6.74	96.5	6.79
17.0	5.85	37.0	6.47	57.0	6.65	77.0	6.74	97.0	6.79
17.5	5.89	37.5	6.47	57.5	6.65	77.5	6.74	97.5	6.79
18.0	5.92	38.0	6.48	58.0	6.66	78.0	6.74	98.0	6.79
18.5	5.95	38.5	6.49	58.5	6.66	78.5	6.74	98.5	6.79
19.0	5.97	39.0	6.49	59.0	6.66	79.0	6.74	99.0	6.79
19.5	6.00	39.5	6.50	59.5	6.66	79.5	6.75	99.5	6.79
20.0	6.02	40.0	6.50	60.0	6.67	80.0	6.75	100.0	6.80

Supplemental Notice to Notice 2010-60 Providing Further Guidance and Requesting Comments on Certain Priority Issues Under Chapter 4 of Subtitle A of the Code

Notice 2011-34

PURPOSE

On March 18, 2010, the Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-147 (H.R. 2847) (the Act) was enacted into law. Section 501(a) of the Act added a new chapter 4 (sections 1471 - 1474) to Subtitle A of the Internal Revenue Code (Code). Chapter 4 expands the information reporting requirements imposed on foreign financial institutions (as defined in section 1471(d)(4)) (FFIs) with respect to certain United States accounts (as defined in section 1471(d)(1)) (U.S. accounts), and imposes withholding, documentation, and reporting requirements with respect to certain payments made to certain foreign entities.

On August 27, 2010, the Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) published Notice 2010-60, 2010-37 I.R.B. 329, to provide preliminary guidance regarding priority issues involving the implementation of chapter 4 and to request comments on the issues addressed in Notice 2010-60 and certain other issues to be addressed in future published guidance. Unless otherwise indicated, all chapter and section references are to the Code and the regulations thereunder. Except as otherwise provided, all terms used in this notice shall have the same meaning as set forth in sections 1471 through 1474 and Notice 2010-60.

This notice provides guidance in response to certain priority concerns identified by commentators following the publication of Notice 2010-60 and requests further comments with respect to specific issues. Treasury and the IRS intend to issue regulations incorporating the guidance described in this notice and addressing other matters necessary to implement chapter 4. In addition, Treasury and the IRS intend to publish draft FFI Agreements and draft information reporting and certification forms.

Section I of this notice provides updated guidance regarding the procedures to be followed by participating FFIs in identifying U.S. accounts among their preexisting individual accounts. Section II provides guidance regarding the definition of the term “passthru payment” for purposes of chapter 4 and provides guidance with respect to the obligation of participating FFIs to withhold on passthru payments. Section III provides guidance regarding certain categories of FFIs that will be deemed compliant under section 1471(b)(2). Section IV provides further guidance regarding the obligation of participating FFIs to report with respect to U.S. accounts. Section V addresses the treatment under section 1471 of Qualified Intermediaries (as defined in § 1.1441-1(e)(5)(ii)) (QIs). Section VI provides guidance regarding the application of section 1471 to expanded affiliated groups of FFIs under section 1471(e). Section VII states the effective date of FFI Agreements.

Section I. Preexisting Individual Accounts

This section modifies the procedures provided in Notice 2010-60 for a participating FFI to identify U.S. accounts among its preexisting individual accounts. It also describes a new procedure for participating FFIs to certify their completion of the requirements for determining the status of their preexisting individual accounts.

Section III.B.2.a of Notice 2010-60 provides procedures for participating FFIs to identify U.S. accounts among their preexisting individual accounts. Treasury and the IRS have received several comments about aspects of these procedures that present compliance challenges to FFIs.

First, comments suggested that many FFIs would be unable as a practical matter to apply the exclusion in Step 1 of Section III.B.2.a of Notice 2010-60 for accounts of \$50,000 or less because of legal restrictions on the sharing of account holder information across branches or affiliates located in different jurisdictions and because of certain limitations of many FFIs’ information technology systems.

Second, comments raised concerns about treating a non-U.S. P.O. box as an indication of U.S. status because in certain countries a significant percentage of the

population uses P.O. boxes as their sole address. Accordingly, treating a non-U.S. P.O. box as an indication of U.S. status could result in a large number of account holders with no connection to the United States potentially being treated as recalcitrant account holders.

Third, comments requested clarification of the terms “electronically searchable information” and “documentary evidence” as used in Section III.B.2.a of Notice 2010-60. Finally, comments raised concerns with the potential costs that participating FFIs would incur if they were required to apply the new individual account identification procedures described in Section III.B.2.b of Notice 2010-60 to preexisting individual accounts (with limited exceptions) within five years after the effective date of the FFI’s FFI Agreement, as set forth in Section III.B.2.a of Notice 2010-60.

After considering these comments, Treasury and the IRS intend to revise the procedures for identifying U.S. accounts among preexisting individual accounts described in Section III.B.2.a of Notice 2010-60. Subsection A, below, sets forth a description of these revised procedures, and replaces Section III.B.2.a of Notice 2010-60 in its entirety.

A. Revised Procedures for Identification of Preexisting Individual Accounts

1. Definitions

The following definitions apply for purposes of this notice:

(1) A “preexisting individual account” is any financial account held by an individual as of the date that a participating FFI’s FFI Agreement becomes effective.

(2) A “private banking account” is any account maintained or serviced by an FFI’s private banking department or any account maintained or serviced as part of a private banking relationship, including any account held by any entity, nominee, or other person to the extent the account is associated with the private banking relationship with an individual client.

(3) A “private banking department” is any department, unit, division, or similar part of an FFI:

(A) that is referred to by the FFI as a private banking, wealth management, or similar department;

(B) that focuses on servicing accounts and investments of individual clients (or their families) whose accounts with the FFI or whose income, earnings, or assets exceed certain thresholds, or who are otherwise identified as high-net worth individuals (or families), as determined under an FFI's own policies and procedures;

(C) that is considered a private banking department under the anti-money laundering or know-your-customer (AML/KYC) requirements to which the FFI is subject; or

(D) in which some or all of its employees, under any of an FFI's formal or informal procedures or other guidelines for its personnel: (i) ordinarily provide personalized services to individual clients (or their families), such as banking, investment advisory, trust and fiduciary, estate planning, philanthropic, or other services not generally provided to account holders; or (ii) gather information about individual clients' personal, professional, and financial histories in addition to the information ordinarily gathered with respect to the FFI's retail customers.

(4) A "private banking relationship" exists when one or more officers or other employees of the FFI are assigned by the FFI to provide services such as those described in clause (D)(i) of the definition of a private banking department or to gather information about a client (or the client's family) of the type described in clause (D)(ii) of the definition of a private banking department, regardless of whether the assigned individual is employed within the FFI's private banking department.

(5) A "private banking relationship manager" is an officer or other employee of the FFI who: (i) is assigned responsibility for specific account holders on an ongoing basis; (ii) advises account holders regarding their banking, investment, trust and fiduciary, estate planning, or philanthropic needs; and (iii) recommends, makes referrals to, or arranges for the provision of financial products, services, or other assistance by internal or external providers to meet those needs.

(6) Except as otherwise provided for purposes of chapter 4, the term "documentary evidence" includes: (i) documentary evidence sufficient to establish the identity of an individual and the status of that person as a non-U.S. person (consistent with the documentary evidence that may be relied upon pursuant to § 1.6049-5(c)(1)), which may include, but is not limited to, photo identification described in § 1.1441-6(c)(4); (ii) any valid document issued by an authorized governmental body that includes the individual's name and address and is typically used for identification purposes; and (iii) with respect to an account maintained in a jurisdiction with AML/KYC rules that have been approved by the IRS in connection with a QI agreement (as referenced in § 1.1441-1(e)(5)(iii)), any of the documents (other than a Form W-8) referenced in the jurisdiction's attachment for identifying natural persons, as shown on the IRS's webpage.

(7) "Documentary evidence establishing non-U.S. status" means documentary evidence that includes the account holder's name and indicates citizenship or residence outside the United States.

(8) "Documentation" includes all information recorded in written or electronic form (including documentary evidence and Forms W-8) that is collected in connection with a financial account (e.g., for purposes of maintaining the account, corresponding with the account holder, or complying with regulatory or AML/KYC requirements).

2. Procedures for Identification by Participating FFIs of Preexisting Individual Accounts

In the case of preexisting individual accounts, the participating FFI is required to determine whether such accounts are to be treated as U.S. accounts, accounts of recalcitrant account holders (recalcitrant accounts), or accounts that are other than U.S. accounts (non-U.S. accounts), according to the steps below. For purposes of applying the procedures of this section, the following rules apply. First, a participating FFI may rely on documentation that is collected pursuant to these procedures or that is otherwise maintained in an ac-

count holder's files, unless it knows or has reason to know that such documentation is unreliable. Second, with respect to preexisting individual accounts, a participating FFI has maintained documentary evidence if the participating FFI retains either: (i) a copy of the documentary evidence; or (ii) a record of the documentary evidence examined, including the type of document and the name of the employee that reviewed the documentary evidence. Third, a participating FFI has maintained a Form W-8BEN (*Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding*) only if it maintains a copy of the form in its files. Fourth, for purposes of determining the balances or values (as relevant) of accounts in each of the below steps, an FFI will be required to treat as a single account all accounts maintained by the FFI or its affiliates that are associated with one another due to partial or complete common ownership of the accounts under the FFI's existing computerized information management, accounting, tax reporting, or other recordkeeping systems. With respect to a jointly held account, each account holder will be attributed the full balance or value of the joint account for purposes of determining the combined balance or value of that account holder's associated accounts.

Step 1: Documented U.S. Accounts

All account holders already documented as U.S. persons for other U.S. tax purposes (e.g., for purposes of chapters 3 and 61) will be treated as specified U.S. persons, and those account holders' financial accounts will be treated as U.S. accounts. Notwithstanding the foregoing, unless the FFI elects otherwise, an account is a non-U.S. account if: (i) the account is a depository account; (ii) each holder of such account is a natural person; and (iii) the balance or value of such account as of the end of the calendar year preceding the effective date of the FFI's FFI Agreement does not exceed \$50,000 (or the equivalent in foreign currency).

Step 2: Accounts of \$50,000 or Less

From among the accounts not identified as U.S. accounts in Step 1, the FFI may treat an account as a non-U.S. account if the balance or value of the account as of the end of the calendar year preceding the

effective date of the FFI's FFI Agreement does not exceed \$50,000 (or the equivalent in foreign currency). An FFI may elect not to apply this Step 2.

Step 3: Private Banking Accounts

With respect to private banking accounts maintained by the FFI that are not addressed in Step 1 or 2, the FFI must perform the steps described below. For purposes of this Step 3, a participating FFI will not be entitled to rely on any documentation received from a client or from an individual holding an account associated with the client if the private banking relationship manager knows or has reason to know that the information contained in such documentation is unreliable or incorrect.

- A. The FFI must ensure that all of the FFI's private banking relationship managers:
- i. identify any client of the private banking relationship manager for which the private banking relationship manager has actual knowledge that the client is a U.S. person and request that each such client provide a Form W-9 (*Request for Taxpayer Identification Number and Certification*);
 - ii. perform a diligent review of the paper and electronic account files and other records for each client with respect to whom they serve as a private banking relationship manager, and identify each client (including any associated family members) who, to the best of the knowledge of the private banking relationship manager, has:
 - a. U.S. citizenship or lawful permanent resident (green card) status;
 - b. a U.S. birthplace;
 - c. a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box);
 - d. standing instructions to transfer funds to an account maintained in the United States, or directions regularly received from a U.S. address;
 - e. an "in care of" address or a "hold mail" address that is

the sole address with respect to the client; or

- f. a power of attorney or signatory authority granted to a person with a U.S. address.
- iii. with respect to each client identified in Step 3(A)(ii):
- a. request documentation to establish whether the client's account is a U.S. account. In particular, the private banking relationship manager must request that each client identified as a U.S. citizen or lawful permanent resident in Step 3(A)(ii)(a) provide a Form W-9. In the case of any client identified as having a U.S. birthplace or address in Step 3(A)(ii)(b) or (c), the private banking relationship manager must request that the client provide either a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and a non-U.S. passport or other similar government-issued evidence establishing the client's citizenship in a country other than the United States. In addition, to establish non-U.S. status in the case of any client identified as having a U.S. birthplace in Step 3(A)(ii)(b), the private banking relationship manager will be required to obtain from the client a written explanation regarding the client's renunciation of U.S. citizenship or reason that the client did not acquire U.S. citizenship at birth. In the case of any client identified as having standing instructions or directions in Step 3(A)(ii)(d), the private banking relationship manager must request that the client provide a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and documentary evidence

establishing non-U.S. status of the client. In the case of any client identified as having only an "in care of" or "hold mail" address or a power of attorney in Step 3(A)(ii)(e) or (f), the private banking relationship manager must request that the client provide a Form W-9 establishing U.S. status, a Form W-8BEN (or a substitute certification as may be provided in future guidance), or documentary evidence establishing non-U.S. status.

- b. request that any client providing a Form W-9 establishing U.S. status in response to a request under Step 3(A)(iii)(a) also provide a waiver of applicable restrictions, if any, on reporting of the client's information to the IRS.
- iv. treat all accounts associated with a client as U.S. accounts (or, to the extent applicable, as Documented FFIs under Section II.B.3 of Notice 2010-60) if the client is identified as a U.S. person in Step 3(A)(i), or is identified as having U.S. indicia as described in Step 3(A)(ii) and does not establish non-U.S. status as described in Step 3(A)(iii)(a). Notwithstanding the prior sentence, an account held solely by a family member of the client who provides a Form W-8BEN (or a substitute certification establishing non-U.S. status as may be provided in future guidance) and documentary evidence establishing the non-U.S. status of the family member will not be treated as a U.S. account, unless the private banking relationship manager knows or has reason to know the family member is acting as a nominee or agent for the client; and
- v. create and retain lists of all existing clients whose accounts are U.S. accounts, non-U.S. accounts, or recalcitrant accounts.
- B. The FFI must complete the procedures described in Step 3(A) by the end of the first year in which an FFI's

FFI Agreement is in effect. If a private banking relationship manager subsequently becomes aware that an account holder of a preexisting private banking account has any of the U.S. indicia described in Step 3(A)(ii), the private banking relationship manager must request the documentation described in Step 3(A)(iii) from the account holder, and, if the account holder does not establish non-U.S. status pursuant to Step 3(A)(iii) within one year of the date on which the private banking relationship manager discovers the U.S. indicia, include the account in the FFI's reporting of its U.S. accounts or treat the account as a recalcitrant account.

- C. The FFI must ensure that all accounts identified in Step 3(A) for which the account holder has provided a Form W-9 and agreed to waive any applicable restrictions on reporting of their information to the IRS are included in the FFI's reporting of its U.S. accounts. Further, the FFI must ensure that all accounts for which the account holders either have not provided the documentation required in Step 3(A) above or, in the case of U.S. persons, have not agreed to waive any applicable restrictions on reporting of their information to the IRS, are treated as recalcitrant account holders after the end of the first year in which the FFI's FFI Agreement is in effect and are included in the FFI's reporting with respect to such accounts. An FFI's due date for reporting U.S. accounts and information regarding recalcitrant account holders will be the designated reporting dates (to be prescribed) following the close of the first full year covered by the FFI's FFI Agreement.
- D. The FFI must ensure that all of the written requests and responses related to the search are retained by the FFI for ten years.

Step 4: Accounts with U.S. Indicia

- A. From among the accounts that are not identified as U.S. accounts in Step 1, as non-U.S. accounts in Step 2, or as private banking accounts under Step 3, the FFI shall determine whether the electronically searchable information maintained by the FFI and associated

with those accounts or account holders (e.g., customer information kept for purposes of maintaining the account, corresponding with the account holder, or complying with regulatory requirements) includes any of the following U.S. indicia:

- i. identification of an account holder as a U.S. resident or U.S. citizen;
- ii. a U.S. place of birth for an account holder;
- iii. a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box);
- iv. standing instructions to transfer funds to an account maintained in the United States;
- v. an "in care of" address or a "hold mail" address that is the sole address shown in the FFI's electronically searchable information for the account holder; or
- vi. a power of attorney or signatory authority granted to a person with a U.S. address.

For this purpose, "electronically searchable information" refers to information that an FFI maintains in its tax reporting files, or customer master files or similar files, that is stored in the form of an electronic database against which standard queries in programming languages, such as Structured Query Language, may be used. Customer master files include an FFI's primary files for maintaining account holder information, such as information used for contacting account holders and for satisfying AML/KYC requirements. Information, data, or files are not electronically searchable merely because they are stored in an image retrieval system (such as .pdf files or scanned documents).

- B. For all accounts identified as containing U.S. indicia described in Step 4(A), the FFI will be required within one year of the effective date of the FFI's FFI Agreement to request certain documentation to establish whether the account is a U.S. account. In particular, if an account holder is identified as a U.S. resident or citizen in Step 4(A)(i), the FFI shall request a Form W-9 from such individual. If the account information includes a

U.S. birthplace or address identified in Steps 4(A)(ii) or (iii), the FFI shall request either a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and a non-U.S. passport or other government-issued evidence of citizenship in a country other than the United States. In addition, to establish non-U.S. status in the case of any account holder identified as having a U.S. birthplace, the account holder will be required to provide a written explanation regarding the account holder's renunciation of U.S. citizenship or reason that the account holder did not acquire U.S. citizenship at birth. In the case of any account identified as having standing instructions in Step 4(A)(iv), the FFI shall request either a Form W-9 establishing U.S. status, or a Form W-8BEN (or a substitute certification as may be provided in future guidance) and documentary evidence establishing non-U.S. status. If the account is identified as containing only an "in care of" or "hold mail" address or a power of attorney described in Steps 4(A)(v) or (vi), the FFI shall request a Form W-9 establishing U.S. status, a Form W-8BEN (or a substitute certification as may be provided in future guidance), or documentary evidence establishing non-U.S. status. Account holders that have not provided appropriate documentation within two years of the effective date of the FFI's FFI Agreement will be classified as recalcitrant account holders from that date until the date on which appropriate documentation is received from the account holder by the participating FFI.

Step 5: Accounts of \$500,000 or More

For all preexisting individual accounts that are not identified as U.S. accounts in Step 1, as non-U.S. accounts in Step 2, as private banking accounts in Step 3, or as accounts with U.S. indicia in Step 4, and that had a balance or value of \$500,000 or more at the end of the year preceding the effective date of the FFI's FFI Agreement (high value accounts), the FFI must perform a diligent review of the account files associated with the account. To the extent

that the account files contain any of the U.S. indicia described in Step 4(A)(i)-(vi), the FFI must obtain the appropriate documentation as indicated in Step 4(B) within two years of the effective date of the FFI's FFI Agreement. Account holders that do not provide appropriate documentation by the required date will be classified as recalcitrant account holders until the date on which appropriate documentation is received from the account holder by the participating FFI.

Step 6: Annual Retesting

Beginning in the third year following the effective date of the FFI Agreement, the FFI will be required to apply Step 5 annually to all preexisting individual accounts that did not previously satisfy the account balance or value threshold and other requirements to be treated as high value accounts, but that would be high value accounts under Step 5 if the account balance or value of the account were tested on the last day of the preceding year. From among the accounts identified each year under this test, the FFI will be required to treat as recalcitrant any account for which the required documentation has not been provided by the end of the year.

3. Certifying Completion of Customer Identification Procedures

The chief compliance officer or another equivalent-level officer of the FFI (responsible officer) must certify to the IRS when the FFI has completed the above procedures (other than the annual retesting described in Step 6) for its preexisting individual accounts. The responsible officer will certify to the FFI's completion of Steps 1 through 3 within one year after the effective date of the FFI's FFI Agreement, and will certify to the FFI's completion of Step 4 and Step 5 within two years after the effective date of the FFI's FFI Agreement. As part of these certifications, the responsible officer will be required to certify that, between the publication date of this notice and the effective date of the FFI's FFI Agreement, FFI management personnel did not engage in any activity, or have any formal or informal policies and procedures in place, directing, encouraging, or assisting account holders with respect to strategies for avoiding identifica-

tion of their accounts as U.S. accounts under the procedures described above. The responsible officer will further be required to certify that the FFI had written policies and procedures in place as of the effective date of the FFI's FFI Agreement prohibiting its employees from advising U.S. account holders on how to avoid having their U.S. accounts identified. Treasury and the IRS intend to provide in future guidance the due dates and associated requirements for the certifications described in this Section I.A.3.

B. Future Guidance and Request for Public Comment

Treasury and the IRS solicit comments on appropriate ways to modify the application of the private banking test described in Step 3 in order to ensure that the test will apply, whenever practical, to the accounts of high-net-worth individuals and individuals who receive from FFIs services of the type described in Section I.A.1(3)(D)(i) in the definition of a private banking department and thereby reduce the number of accounts that will be subject to Step 5.

Treasury and the IRS recognize that the procedures described in Step 3 are most relevant to those FFIs that engage in banking, brokerage, and similar businesses. Treasury and the IRS are considering whether other FFIs should apply analogous procedures to certain classes of accounts they maintain. Accordingly, Treasury and the IRS seek comments concerning whether other FFIs, and in particular insurance companies, should perform procedures similar to those described above with respect to holders of preexisting individual accounts, including private placement life insurance.

Treasury and the IRS intend to require FFIs to adopt the procedures described in this section with regard to private banking accounts for any preexisting individual accounts that become private banking accounts after the procedures in Step 3 above are performed, including requiring the responsible officer to provide a certification regarding the completion of Step 3 with regard to such accounts. Treasury and the IRS are considering adopting the private banking test described in Step 3 for new accounts that are or become private banking accounts.

C. Long Term Recalcitrant Account Holders

As noted in Notice 2010-60, withholding with respect to recalcitrant account holders is intended to provide relief for participating FFIs that would not otherwise be able to collect the information required to comply with their obligations under their FFI Agreements. It should not, however, become a permanent substitute for collecting and reporting information with respect to U.S. accounts. Treasury and the IRS continue to consider what measures should be taken to address long-term recalcitrant accounts, including whether, and in what circumstances, FFI Agreements should be terminated due to the number of recalcitrant account holders remaining after a reasonable period of time.

Section II. Passthru Payments

This section provides guidance regarding the definition of the term "passthru payment" for purposes of chapter 4 and regarding the obligation of a participating FFI to withhold on a passthru payment. This section also provides an exemption from passthru payment withholding for obligations that are grandfathered under section 501(d)(2) of the Act. See Section I of Notice 2010-60.

Section 1471(b)(1)(D) requires a participating FFI to deduct and withhold a tax equal to 30 percent of any passthru payment made to a recalcitrant account holder or non-participating FFI. A passthru payment is defined under section 1471(d)(7) as any withholdable payment or other payment to the extent attributable to a withholdable payment.

In Notice 2010-60, Treasury and the IRS requested comments on methods that a participating FFI could use to determine whether payments it makes are attributable to withholdable payments, including any associated information reporting that may be necessary. In response, Treasury and the IRS have received several comments proposing that a payment attributable to a withholdable payment should include only payments that are either withholdable payments or directly traceable to withholdable payments. These approaches would not, however, be consistent with the purposes underlying the passthru payment concept.

As described in Notice 2010–60, one purpose of the passthru payment rule is to encourage FFIIs to enter into FFI Agreements if they hold investments that produce payments that are attributable to withholdable payments, even if they do not directly hold assets that produce withholdable payments. Without such a rule, participating FFIIs could be used as “blockers” through which non-participating FFIIs might benefit from indirect investment in U.S. assets (as defined below) without being subject to withholding or entering into an FFI Agreement. The approach suggested by the comments described above would largely limit the definition of passthru payments to payments that would constitute withholdable payments and thus would fail to address account holders who invest in U.S. assets indirectly. Moreover, given the diversity of capital structures and payment arrangements of FFIIs, a rule that defined passthru payments based on whether a payment was “directly traceable” to a withholdable payment would be difficult for FFIIs to apply and the IRS to administer. Accordingly, Treasury and the IRS have not adopted the limited definition of a passthru payment proposed in such comments.

Other comments suggested broader definitions of passthru payments, including approaches focusing on the FFI’s ratio of assets giving rise to withholdable payments or passthru payments to total assets as a means to make the passthru payment rules administrable. This approach would more effectively accomplish the purposes of the passthru payment provision of chapter 4 and avoid the complications presented by implementing a tracing approach.

A. General Rule

Treasury and the IRS intend to issue regulations providing that, subject to the exceptions described below or in future guidance, a payment made by an FFI (the payor FFI) will be a passthru payment to the extent of: (i) the amount of the payment that is a withholdable payment; plus (ii) the amount of the payment that is not a withholdable payment multiplied by (A) in the case of a custodial payment (as defined in Section II.C below), the passthru payment percentage of the entity that issued the interest or instrument, or (B) in

the case of any other payment, the passthru payment percentage of the payor FFI.

B. Calculation of Passthru Payment Percentage

1. In General

In order to calculate its passthru payment percentage, an FFI must determine its total assets and U.S. assets, as defined below in Sections II.B.3 and II.B.4, respectively, as of its quarterly testing dates. The FFI’s passthru payment percentage will be determined by dividing the sum of the FFI’s U.S. assets (as defined in Section II.B.4) held on each of the last four quarterly testing dates, by the sum of the FFI’s total assets (as defined in Section II.B.3) held on those dates. FFIIs will determine their passthru payment percentages as of each quarterly testing date.

The quarterly testing date for an FFI will be either the last redemption date of the quarter (for entities that conduct redemptions at least quarterly) or the last business day of the quarter (for all other entities). A quarter will be determined in accordance with the FFI’s fiscal year. Any participating FFI which does not calculate and publish its passthru payment percentage, as set forth in Section II.B.5 will be deemed to have a passthru payment percentage of 100 percent.

Treasury and the IRS request comments as to whether alternative methods for determining passthru payment percentages (such as permitting reliance upon representations in investor solicitation or proxy materials regarding target percentage holdings of U.S. assets) may be appropriate and administrable under certain circumstances.

2. Alternative Transition Method for Computing Passthru Payment Percentage

In lieu of the general rule described in Section II.B.1, above, an FFI may elect to compute its passthru payment percentage in the first year of its FFI Agreement under the following alternative method. An FFI may calculate its passthru payment percentage to be used for the first quarter of the first year of its FFI Agreement based on the FFI’s assets on a single testing date (Initial Testing Date). The Initial Testing Date may be any date in the six months preceding the effective date of the FFI’s FFI Agreement. For the quarterly testing

dates falling in each of the first three complete quarters after the effective date of the FFI’s FFI Agreement, the FFI will determine its passthru payment percentage by dividing the sum of the FFI’s U.S. assets held on the Initial Testing Date and each of the quarterly testing dates by the sum of the FFI’s total assets held on the Initial Testing Date and each of the quarterly testing dates.

3. Determination of Assets

For purposes of calculating an FFI’s passthru payment percentage, an asset generally includes any asset includible on a balance sheet of an FFI prepared under the FFI’s method of accounting for reporting to its interest holders. An asset will also include off-balance sheet transactions or positions to the extent provided in future guidance. Assets held in a custodial account of an FFI will not be considered assets of the FFI for purposes of computing its passthru payment percentage. A custodial account is an account with respect to which a financial institution acts as a custodian, broker, nominee, or agent for the benefit of the account holder. All assets are includable for purposes of an FFI’s passthru payment percentage calculations at their gross values, unreduced by liabilities or other associated obligations.

The value of an asset is the amount shown on the quarterly financial statements issued by the FFI for purposes of reporting to its interest holders. If no such financial statements are issued for a quarterly testing date, then the value of an asset shall be determined consistent with the method used on the most recently issued financial statements to interest holders. An FFI’s assets must be translated into a single currency (which need not be the U.S. dollar) for purposes of computing its passthru payment percentage.

4. Definition of “U.S. Asset”

For purposes of determining an FFI’s passthru payment percentage, Treasury and the IRS intend to publish regulations defining a U.S. asset to include any asset to the extent that it is of a type that could give rise to a passthru payment. Notwithstanding the previous sentence, an FFI’s debt or equity interest in a domestic corporation will be treated solely as a U.S. asset and an FFI’s debt or equity interest

in a non-financial foreign entity (NFFE) shall be treated solely as a non-U.S. asset, regardless of whether the interest would otherwise be an asset of a type that could give rise to a passthrough payment.

The above definition of U.S. asset also includes certain interests in or other financial accounts that are not custodial accounts (non-custodial accounts) held with another FFI. An interest in, or other non-custodial account held with, another FFI (Lower Tier FFI) constitutes a U.S. asset in an amount equal to the value of the interest in, or account with, the Lower Tier FFI multiplied by the Lower Tier FFI's passthrough payment percentage. An FFI may rely on the passthrough payment percentage of a Lower Tier FFI that is a participating or deemed-compliant FFI, if such FFI publishes its passthrough percentage as provided in Section II.B.5, below. If a participating FFI or deemed-compliant FFI does not calculate or publish its passthrough payment percentage as set forth in Section II.B.5, it will be deemed to have a passthrough payment percentage of 100 percent. An FFI that is not a participating or deemed-compliant FFI will be presumed to have a passthrough payment percentage of zero percent. An FFI will be required to confirm that a Lower Tier FFI is not a participating or deemed-compliant FFI prior to presuming that the Lower Tier FFI has a passthrough payment percentage of zero percent. The IRS intends to maintain a database that will permit FFIs and other withholding agents to confirm whether an FFI is a participating or deemed-compliant FFI.

Example of Calculation of Passthrough Payment Percentage. Fund A is a participating FFI that operates as a fund of funds and that elects the book value (BV) method for determining the value of its assets. As of the relevant testing date, Fund A's assets consist of: (a) an interest in Fund B, a non-participating FFI (BV of \$20 million); (b) an interest in Fund C, a participating FFI with a passthrough payment percentage (PP%) of 50 percent (BV of \$30 million); (c) an interest in Fund D, an FFI that does not calculate its PP% (BV of \$10 million); (d) an interest in Fund E, a domestic corporation (BV of \$40 million). Fund A's total assets are \$100 million. Fund A's U.S. assets are \$65 million ($(\$20 \text{ million} \times \text{Fund B's PP\% of } 0\%) + (\$30 \text{ million} \times \text{Fund C's PP\% of } 50\%) + (\$10 \text{ million} \times \text{Fund D's PP\% of } 100\%) + (\40

million $\times 100\%$ because Fund E is a U.S. entity)). Therefore, Fund A's passthrough payment percentage for the relevant testing date is equal to \$65 million (U.S. assets) / \$100 million (total assets), or 65 percent.

Treasury and the IRS intend to issue guidance providing that an FFI that has engaged in a pattern of selling or transferring any of its U.S. assets immediately prior to its quarterly testing date and reacquiring the same or similar assets following the quarterly testing date, or otherwise engaging in transactions with the intent of manipulating its passthrough payment percentage, will be treated as having its passthrough payment percentage determined without regard to those transactions, regardless of how such transactions would be characterized under the FFI's financial accounting standards for purposes of reporting to its interest holders. Comments are requested regarding any further anti-abuse rules which may be necessary to prevent the manipulation of an FFI's passthrough payment percentage.

Comments are also requested regarding the above approach to defining a U.S. asset. Additionally, Treasury and the IRS are seeking comments regarding the use of the passthrough payment percentage with respect to domestic and foreign partnerships and other flow-through entities, as well as how a partnership or other flow-through entity may determine whether a payment it makes to an interest holder is a withholdable payment or a passthrough payment. Comments are also requested regarding whether it is appropriate to permit a U.S. financial institution that is a partnership or other flow-through entity under U.S. tax principles to calculate and make available a passthrough payment percentage that may be used by participating FFIs in determining their own passthrough payment percentages with respect to non-custodial accounts held with such U.S. institutions.

5. Timing and Publishing of Passthrough Payment Percentages

Each participating FFI will be required within three months after its quarterly testing date to make available its passthrough payment percentage information calculated for that testing date, for example, on a website or database readily searchable by the public. Treasury and the IRS request comments on the most efficient

mechanism for ensuring that accurate passthrough payment percentage information is readily available to FFIs for purposes of administering their obligations under chapter 4. Treasury and the IRS intend that a participating or deemed-compliant FFI that fails to make available updated passthrough payment percentage information will be treated as having a passthrough payment percentage of 100 percent. Treasury and the IRS further intend that an FFI that holds an interest in one or more Lower Tier FFIs may rely on such FFI's most recently published passthrough payment percentage in determining its own passthrough payment percentage. The determination of when a passthrough payment percentage is out-of-date and how frequently an FFI must check for more recently published passthrough payment percentages of other FFIs shall be set forth in future guidance.

If deemed-compliant FFIs publish their passthrough payment percentages, they must certify to the IRS every three years that the passthrough payment percentages they publish are accurate. See also Section III of this notice concerning other proposed rules applicable to deemed-compliant FFIs.

C. Custodial Payments

A custodial payment is a payment with respect to which an FFI acts as a custodian, broker, nominee, or otherwise as an agent for another person. A custodial payment that is a withholdable payment will be treated as a withholdable payment (and thus as a passthrough payment), and the FFI must apply the appropriate withholding unless the withholding obligation has been satisfied by another withholding agent. As described above, if the custodial payment is made with respect to an interest or instrument issued by another FFI (issuer FFI), then the custodial payment is a passthrough payment in an amount equal to the amount of the payment multiplied by the passthrough payment percentage of the issuer FFI.

For example, consider an FFI that holds stock of a domestic corporation in a custodial account for a recalcitrant account holder. Upon receiving a dividend from the domestic corporation, the FFI must treat the dividend as a passthrough payment when credited to the account of the recalcitrant account holder because the dividend constitutes a withholdable payment.

Similarly, when a broker that is a participating FFI holds an interest in another FFI on behalf of a recalcitrant account holder and collects a distribution from that other FFI on behalf of the account holder, the portion of that distribution constituting a passthrough payment is equal to the amount of the distribution multiplied by that other FFI's passthrough payment percentage. Since the broker is acting in a custodial capacity with respect to the distribution paid or credited to the account of the recalcitrant account holder, the broker's own passthrough payment percentage does not affect the application of the passthrough payment rules to the distribution.

D. Grandfathered Obligations

An obligation that gives rise to payments that are exempt from withholding under section 501(d)(2) of the Act (grandfathered obligation), including any accrual of income with respect to such obligation, will not be treated as a U.S. asset for purposes of determining an entity's passthrough payment percentage. A grandfathered obligation also will not give rise to a passthrough payment under the rules for custodial payments described in Section II.C above.

E. Request for Comments Regarding Potential Exceptions to Passthrough Payments

Treasury and the IRS request comments regarding possible exemptions from the definition of passthrough payments that would, to the extent possible, be consistent with the policy goals of the passthrough payment rule and reasonable in light of the potential burden on participating FFIs.

Section III. Deemed-Compliant Status for Certain FFIs

This section describes certain categories of FFIs that will be deemed compliant pursuant to section 1471(b)(2). Unless provided otherwise, a deemed-compliant FFI will be required to: (1) apply for deemed-compliant status with the IRS; (2) obtain an FFI identification number (FFI-EIN) from the IRS identifying it as a deemed-compliant FFI; and (3) certify every three years to the IRS that it meets the requirements for such treatment.

A. Certain Local Banks

Treasury and the IRS intend to issue regulations under which each FFI in an expanded affiliated group (as defined in section 1471(e) and discussed below in Section VI) will be treated as a deemed-compliant FFI under section 1471(b)(2)(A) if: (1) each FFI in the expanded affiliated group is, under the laws of its country of organization, licensed and regulated as a bank or similar organization authorized to accept deposits in the ordinary course of its business and is not described in section 1471(d)(5)(C); (2) all of the FFIs in the expanded affiliated group are organized in the same country; (3) no FFI in the expanded affiliated group maintains operations outside the country of organization; (4) no FFI in the expanded affiliated group solicits account holders outside its country of organization; and (5) each FFI in the expanded affiliated group implements policies and procedures to ensure that it does not open or maintain accounts for non-residents, non-participating FFIs, or NFFEs (other than excepted NFFEs as defined in Notice 2010-60 that are organized and operating in the jurisdiction where all members of the expanded affiliated group are organized). Treasury and the IRS solicit comments on how an expanded affiliated group would demonstrate to the IRS that it meets the requirements described above.

B. Local FFI Members of Participating FFI Groups

Treasury and the IRS also intend to issue regulations under which any FFI that is a member of an expanded affiliated group that includes one participating FFI (each an "FFI member" of a "Participating FFI Group") may be treated as a deemed-compliant FFI under section 1471(b)(2)(A) if: (1) the FFI member maintains no operations outside its country of organization; (2) the FFI member does not solicit account holders outside its country of organization; (3) the FFI member implements the pre-existing account and customer identification procedures required of participating FFIs to identify the following types of accounts: (a) U.S. accounts; (b) accounts of non-participating FFIs; and (c) accounts of NFFEs (other than excepted NFFEs as defined in Notice 2010-60 that are organized and operating in the juris-

dition where the FFI member maintains the account); and (4) the FFI agrees that, if any of the types of accounts described in clause (3) above are found, it will enter into an FFI Agreement, transfer such accounts to an affiliate that is a participating FFI within a reasonable period of time to be provided in future guidance, or close such accounts. Treasury and the IRS solicit comments on how an FFI would demonstrate to the IRS that it meets the requirements described above. In addition, Treasury and the IRS request comments as to whether there are policies and procedures other than the customer identification procedures required of participating FFIs that an FFI member of a Participating FFI Group could apply to effectively ensure that it identifies any U.S. accounts that it opens or maintains.

C. Certain Investment Vehicles

In addition, Notice 2010-60 stated that Treasury and the IRS were considering whether, under the standard set forth in section 1471(b)(2)(A), certain investment vehicles could be deemed to meet the requirements of section 1471(b). Treasury and the IRS intend to issue guidance under which certain collective investment vehicles and other investment funds would be treated as deemed-compliant under section 1471(b)(2)(A). Under this guidance, a fund will be deemed-compliant if it meets the following three requirements: (1) all holders of record of direct interests in the fund (e.g., the holders of its units or global certificates) are participating FFIs or deemed-compliant FFIs holding on behalf of other investors, or entities described in section 1471(f); (2) the fund prohibits the subscription for or acquisition of any interests in the fund by any person that is not a participating FFI, a deemed-compliant FFI, or an entity described in section 1471(f); and (3) the fund certifies that any passthrough payment percentages that it calculates and publishes will be done in accordance with Section II of this notice.

Treasury and the IRS are also considering under what circumstances certain foreign entities, all the interests in which are regularly traded on an established securities market (e.g., exchange-traded funds (ETFs)), could be deemed compliant under section 1471(b)(2)(A). FFIs that is-

sue only debt or equity interests that are regularly traded on an established securities market do not maintain “financial accounts” under section 1471(d)(2)(C). Although such FFIs maintain no U.S. accounts, they are FFIs and are subject to certain obligations under chapter 4 to the extent they receive passthru payments. In particular, such FFIs would be required to enter into an FFI Agreement, withhold on passthru payments made to non-participating FFIs, and certify that any passthru payment percentage that they publish will be published in accordance with Section II.B.5.

Treasury and the IRS continue to consider comments received regarding whether there may be a category of funds that may be treated as deemed-compliant because: (i) all direct interest holders in the fund are participating FFIs, USFIs, deemed-compliant FFIs, entities described in section 1471(f), or non-participating FFIs acting as distributors; (ii) distribution or similar agreements prohibit sales of interests to specified U.S. persons, NFFEs other than excepted NFFEs, and non-participating FFIs holding for their own account; (iii) each distributor agrees to enforce the sales prohibitions described in (ii) above, and (iv) the fund satisfies other requirements and meets other criteria relevant to the purposes of chapter 4.

Many FFIs employ paying agents or transfer agents to act on their behalf in making payments to direct interest holders or maintaining a register of direct interest holders in the fund. Treasury and the IRS intend to issue guidance clarifying that, while a deemed-compliant FFI is responsible for ensuring that the requirements for being deemed compliant are met, it may use an agent to perform the necessary due diligence and take any required action associated with maintaining deemed-compliant status on its behalf. Similarly, a participating FFI is liable for the performance of its obligations under its FFI Agreement, but may use an agent to perform those obligations on its behalf.

D. Other Categories of Deemed-Compliant FFIs

As discussed in Notice 2010–60, Treasury and the IRS intend to issue guidance providing that certain foreign retirement plans pose a low risk of tax evasion

under section 1471(f), and therefore payments beneficially owned by such retirement plans will be exempt from withholding under section 1471(a). Treasury and the IRS are still considering the many comments received regarding the types of foreign retirement plans that should be treated as posing a low risk of tax evasion under section 1471(f), and intend to provide further guidance on the types of foreign retirement plans that may qualify for such treatment. In addition, Treasury and the IRS intend to provide further guidance on foreign retirement plans or retirement accounts that may be deemed compliant under section 1471(b)(2).

Treasury and the IRS request comments regarding other categories of entities that should be treated as deemed-compliant FFIs under section 1471(b)(2)(A) because they possess certain characteristics, or have implemented appropriate policies and procedures, that are consistent with the purpose of the passthru payment rule of section 1471 to prevent these entities from being used by non-participating FFIs to avoid compliance with chapter 4.

Section IV. Reporting on U.S. Accounts

A. Account Balance or Value

This section modifies certain of the proposed U.S. account reporting requirements for FFIs outlined in Section IV of Notice 2010–60.

Section 1471(c)(1)(C) requires a participating FFI to report the account balance or value of each U.S. account unless the FFI elects to report in accordance with section 1471(c)(2). Section IV of Notice 2010–60 provides preliminary guidance regarding the manner and type of information FFIs would be required to report with respect to their U.S. accounts. Notice 2010–60 requires reporting of the highest of the month-end balances during the year (or, if the balance is determined less frequently than monthly (e.g., quarterly) for the purposes of reporting to the account holder, the highest of the balances as determined for purposes of reporting to the account holder during the year) for deposit and custodial accounts. In addition, the FFI would be required to provide additional account-related information (e.g., copies of account statements, including monthly or quarterly balances and

daily receipts and withdrawals) to the IRS upon request. In the case of a U.S. account that is an interest in an entity described in section 1471(d)(5)(C), Notice 2010–60 requires a participating FFI to report the highest value of such account during the year, as determined for the purpose that requires the most frequent determination of value by the participating FFI.

A number of commentators indicated that some FFIs do not retain records of their periodic (month-end, quarterly, or otherwise) account balance determinations. As a result, such FFIs would incur significant costs to comply with this requirement.

In light of these comments and the revised reporting requirements described in Section IV.B of this notice, Treasury and the IRS intend to issue regulations limiting FFIs’ account balance reporting obligations to year-end account balances or values, as determined for purposes of reporting to the account holder or, in the case of a U.S. account that is an interest in an entity described in section 1471(d)(5)(C), as determined for the purpose that requires the most frequent determination of value.

B. Gross Receipts and Withdrawals

Section 1471(c)(1)(D) also requires the reporting of gross receipts and gross withdrawals or payments made to and from U.S. accounts, except to the extent otherwise provided by the Secretary. Notice 2010–60 requested comments as to how to minimize burdens on participating FFIs with respect to their section 1471(c)(1)(D) reporting. Commentators indicated that many FFIs do not currently maintain gross receipt and withdrawal data. These FFIs would have to incur significant costs in order to comply with the section 1471(c)(1)(D) reporting requirement. Commentators also indicated that it would be difficult for FFIs to apply U.S. federal income tax principles when satisfying their section 1471(c)(1)(D) reporting responsibilities.

In light of these comments, Treasury and the IRS intend to issue regulations providing that under section 1471(c)(1)(D) an FFI must annually report the following information with respect to a U.S. account that is described in section 1471(d)(2)(A) or (B):

- i. the gross amount of dividends paid or credited to the account;
- ii. the gross amount of interest paid or credited to the account;
- iii. other income paid or credited to the account; and
- iv. gross proceeds from the sale or redemption of property paid or credited to the account with respect to which the FFI acted as a custodian, broker, nominee, or otherwise as an agent for the account holder.

For purposes of the preceding sentence, the amount and character of dividends, interest, other income, and gross proceeds need not be determined in accordance with U.S. federal income tax principles (though the FFI may rely on such principles). The amount and character of dividends, interest, other income, and gross proceeds may be determined under the same principles that the FFI uses to report information on its resident account holders to the jurisdiction in which the FFI (or branch thereof) is located. If any of these amounts are not reported to the tax administration of the jurisdiction in which the FFI (or branch thereof) is located, such amounts must be determined in the same manner as is used for purposes of reporting to the account holder. If the amount of dividends, interest, gross proceeds, or other income is neither reported to the tax administration of the jurisdiction in which the FFI (or branch thereof) is located nor reported to the account holder, such amounts must be determined either in accordance with U.S. federal tax principles or in accordance with any reasonable method of reporting consistent with the accounting principles generally applied by the FFI. Once an FFI has applied a method to determine such amounts, it must apply such method consistently for all account holders and for all subsequent years unless the Commissioner consents to a change in such method. Consent will be automatically granted for a change to rely on U.S. federal income tax principles to determine such amounts.

In the case of a U.S. account that is described in section 1471(d)(2)(C), the FFI will be required to report with respect to such interest, the gross amount of: (i) all distributions, interest, and similar amounts credited during the year; and (ii) each redemption payment made during the year.

In the case of a U.S. account closed or transferred in its entirety by an account

holder during the year, the FFI will be required to report the income paid or credited to the account for the year until the date of transfer or closure, and will also be required to report the amount or value withdrawn or transferred from the U.S. account as a gross withdrawal. The FFI will also be required to report the U.S. account as closed or transferred.

In addition, the FFI Agreement will provide that if the FFI retains copies of statements sent to holders of U.S. accounts in the ordinary course of its business, such statements must be retained for a period of five years and must be provided to the IRS upon request.

C. Basis Reporting

Treasury and the IRS intend to issue guidance providing that FFIs that are not U.S. payors (as defined in § 1.6049-5(c)(5)) and that report the information required under section 1471(c)(1)(D) with respect to a U.S. account will not be required to report tax basis information required under section 6045(g) with respect to the account.

D. Branch and Affiliate Reporting

1. Mandatory Identification of FFI Branches

Section 1471(b) provides that a participating FFI must report certain information pursuant to an FFI Agreement with respect to each U.S. account. Treasury and the IRS intend to publish draft FFI Agreements that require FFIs, including FFIs that do not elect branch-by-branch reporting under Section IV.E.2, below, to identify the branch that maintains the U.S. account being reported.

2. Branch Reporting Election and Reporting by Affiliates

Treasury and the IRS received comments asserting that some FFIs may face constraints under local law that would prevent consolidating account holder information across branches or affiliates located in different jurisdictions generally, including for purposes of reporting under chapter 4. These commentators noted that those constraints may not prevent branches from reporting separately in order to satisfy the requirements of section 1471(b).

In light of these comments, Treasury and the IRS intend to issue guidance allowing FFIs to elect to have each branch report information regarding the U.S. accounts it maintains and to make the section 1471(c)(2) election with respect to each of their branches. Treasury and the IRS intend to require that such an election be made as part of the application process for an FFI to obtain status as a participating FFI, as further described in Section VI of this notice.

Section V. Chapter 4 Requirements for Qualified Intermediaries

This section addresses the treatment of QIs under section 1471. QIs currently agree to perform certain withholding and reporting responsibilities with regard to their non-U.S. account holders for purposes of chapter 3. They further agree to perform certain reporting responsibilities under chapter 61 with respect to reportable payments made to their U.S. non-exempt recipient account holders and to apply backup withholding under section 3406 on such payments when applicable.

Under section 1471(c)(3), a QI that is an FFI is subject to the requirements of section 1471 in addition to the reporting or other requirements imposed on QIs. Treasury and the IRS intend to issue guidance requiring all FFIs currently acting as QIs to consent to include in their QI agreements the requirement to become participating FFIs unless they qualify as deemed-compliant FFIs under section 1471. This requirement will apply to all such QIs as of January 1, 2013, the effective date of chapter 4. Treasury and the IRS intend to provide transition rules under both chapters 3 and 4 to accommodate this change. FFIs applying for QI status after the effective date of chapter 4 will be required to satisfy the requirements of section 1471.

Treasury and the IRS also intend to issue guidance that will require FFIs currently acting as Foreign Withholding Partnerships (FWPs) or Foreign Withholding Trusts (FWTs) under § 1.1441-5(c) or (e) to consent to include in their agreements the requirement to become participating FFIs unless they qualify as deemed-compliant FFIs under section 1471. FFIs applying for FWP or FWT status after the effective date of chapter 4 will also be re-

quired to satisfy the requirements of section 1471.

Treasury and the IRS intend to coordinate the section 1471 reporting and withholding requirements for QIs, FWPs, and FWTs with the requirements that presently apply to QIs, FWPs, and FWTs under chapter 3 and guidance thereunder, and request comments on how the chapter 3 rules and agreements for these entities may be appropriately modified for that purpose.

Section VI. Application of Section 1471(e) Regarding Expanded Affiliated Groups of FFIs

Section 1471(e) provides that the withholding, reporting, and other requirements imposed on an FFI under section 1471(b) and section 1471(c)(1) shall apply with respect to U.S. accounts maintained by the FFI and, except as otherwise provided by the Secretary, with respect to U.S. accounts maintained by each other FFI (other than any FFI that otherwise meets the requirements of section 1471(b)) which is a member of the same expanded affiliated group that includes the FFI (each an “FFI affiliate” of an “FFI Group”). Under section 1471(e)(2), an expanded affiliated group is an “affiliated group” as defined in section 1504(a), determined by substituting “more than 50 percent” for “at least 80 percent” in each place it appears in section 1504(a) and without regard to paragraphs (2) and (3) of section 1504(b) (which would otherwise exclude insurance companies subject to tax under section 801 and foreign corporations). Section 1471(e)(2) further provides that a partnership or any other entity (other than a corporation) is treated as a member of an expanded affiliated group if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this rule).

A. Requirements for FFI Affiliates

Treasury and the IRS intend to issue regulations under section 1471(e) requiring that each FFI affiliate in an FFI Group must be a participating FFI or a deemed-compliant FFI. Each FFI affiliate in the FFI Group that is to become a participating FFI will be required to execute, under the coordinated execution procedures

described below, an FFI Agreement that will apply to all of its worldwide branches and offices. Each participating FFI affiliate will be responsible for its own due diligence, withholding and reporting obligations, and return filing requirements under its FFI Agreement with respect to its account holders. Each FFI affiliate will be issued its own FFI-EIN. Treasury and the IRS continue to study whether and under what conditions it may be possible to allow an FFI Group to include one or more non-participating FFI affiliates.

B. Execution of Agreements for FFI Affiliates

The IRS intends to require FFI affiliates of FFI Groups to apply for participating FFI or deemed-compliant FFI status through a coordinated application process. For this purpose, the IRS intends to require each FFI Group to designate a “lead FFI.” A lead FFI will be required to complete an application and execute either an agreement with the IRS to become a participating FFI or a certification for deemed-compliant FFI status, and also will be required to complete an application on behalf of each FFI affiliate. The lead FFI will be required to provide the IRS with documentation, in a format to be prescribed, evidencing that each FFI affiliate has agreed to the provisions of an FFI Agreement or certification, depending on whether the FFI affiliate seeks participating or deemed-compliant FFI status. Such documents will include a legally binding authorization from each such FFI affiliate for the lead FFI to act on its behalf in signing the application for participating FFI or deemed-compliant FFI status (as applicable) and in submitting a Form SS-4 (*Application for Employer Identification Number*) to apply for and obtain an FFI-EIN for the FFI affiliate. The lead FFI also will be required to represent in the application that it has identified to the IRS each affiliate in the FFI Group and that it has completed the application in accordance with the instructions provided to it by each affiliate. It will further be required to represent that it is authorized to act as agent for the FFI Group for purposes of an ongoing requirement to notify the IRS of any new FFI affiliate or of any FFI affiliate that ceases to be an FFI affiliate.

The IRS further intends to require that the lead FFI provide certain information in the application about both itself and each affiliate in the FFI Group. The lead FFI will in all cases be required to identify itself as the lead FFI and identify each affiliate of the FFI Group. The lead FFI will be required to provide the following information about each FFI affiliate in the FFI Group: (1) its name, address, and country of organization; (2) whether the FFI affiliate is described in section 1471(d)(5)(A), (B), and/or (C); (3) whether the FFI affiliate is applying as a participating FFI or a deemed-compliant FFI; (4) the types of accounts the FFI affiliate maintains among those specified in section 1471(d)(2); (5) whether the FFI affiliate maintains private banking accounts (as defined in Section I.A.1(2) of this notice); and (6) whether the affiliate is a QI, FWP, or FWT. The lead FFI also will be required to provide the name, address, and country of organization of each member of the FFI Group that is not an FFI. The lead FFI also will be required to identify each FFI affiliate that maintains a branch that elects to separately report its U.S. accounts under Section IV.D.2 of this notice and will be required to identify the jurisdiction of each such branch. Lead FFIs may be required to provide additional information as part of the application process to the extent provided in future guidance.

Once the FFI Agreement has been executed, the IRS intends to require the lead FFI to continue to act as a central contact point with the IRS for issues concerning the application and execution of the agreements and certifications with respect to each FFI affiliate, and concerning any affiliate that is not an FFI. Alternatively, the lead FFI may designate other FFI affiliates to serve as ongoing points of contact (POC FFIs) on behalf of particular members of the FFI Group. For example, a lead FFI may choose to establish a POC FFI for members of the group that share a common line of business or that operate in the same jurisdiction. POC FFIs would also be responsible for addressing issues with the IRS concerning the certifications provided by their associated FFI affiliates in order to maintain deemed-compliant status, or concerning ongoing issues pertaining to any NFFEs in the FFI Group.

C. Centralized Compliance Option for FFI Groups

Treasury and the IRS also intend to provide FFI Groups with an option under which a designated FFI could be appointed by some or all of the FFI affiliates in the FFI Group to assume an oversight role with respect to the compliance by the FFI Group with the section 1471 requirements (Compliance FFIs). For example, a Compliance FFI could assume the responsibility to: (1) establish applicable policies and procedures with respect to the section 1471 requirements for all or a subset of the FFI affiliates in the FFI Group; (2) ensure that all such FFI affiliates have adopted and implemented these policies and procedures; and (3) account to the IRS with respect to each such affiliate's compliance with such policies and procedures and the section 1471 requirements. Treasury and the IRS anticipate that a centralized compliance approach of this type may result in certain efficiencies for both FFIs and the IRS and seek comments about this approach, including the time that Compliance FFIs would need to establish policies and procedures for assuming these additional responsibilities and other suggestions to facilitate a Compliance FFI's role in enforcing its affiliates' compliance with the section 1471 requirements.

Comments are also requested concerning the utility of an option to allow U.S. shareholders of controlled foreign corporations that are FFIs to function as lead FFIs and/or Compliance FFIs (although the U.S. shareholder will not be an FFI).

D. Centralized Option for Funds

Treasury and the IRS are also considering whether a centralized compliance option should be provided for certain col-

lective investment entities (funds) that are associated with a common asset manager or other agent. Under this approach, an asset manager or other agent would execute a single FFI Agreement on behalf of each member of a group of funds that contracts with the asset manager or other agent to perform the functions required under the FFI Agreement with respect to the fund. This option would be restricted to those cases in which the asset manager or other agent is able to monitor each fund's compliance with its FFI Agreement based on its legal agreements and other arrangements with each fund. An asset manager or other agent executing an agreement of this type would be required to act as a point of contact for the IRS with respect to all issues concerning the FFIs in its group, or designate an agent to assume this responsibility. It would further be required to implement policies and procedures covering the section 1471(b) and (c)(1) requirements for each participating FFI fund included in the single agreement, and would also be required to account to the IRS with respect to each such fund's compliance with these procedures and their section 1471 requirements. Each fund participating in an agreement under this option would remain liable for the performance of its obligations under its FFI Agreement. See also Section III.C of this notice concerning the proposed requirements for certain investment funds to obtain deemed-compliant treatment.

Section VII. Effective Date of FFI Agreements

FFI Agreements will become effective on the later of: (i) the date they are executed; or (ii) the effective date of section 501 of the Act.

REQUEST FOR PUBLIC COMMENT

This notice requests public comment regarding the issues described in this notice and regarding other priority issues in connection with forthcoming guidance on the application of chapter 4.

Written comments should be sent to: CC:PA:LPD:PR (NOT-121556-10), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (NOT-121556-10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224 or sent electronically via the Federal eRulemaking Portal at Notice.Comments@irs.counsel.treas.gov (NOT-121556-10). Please insert "Notice 2011-34" in the subject line of any electronic communications.

All comments will be available for public inspection and copying. The deadline for written comments on this notice is June 7, 2011.

EFFECT ON OTHER DOCUMENTS

This notice supplements and supersedes Notice 2010-60 to the extent indicated herein.

DRAFTING INFORMATION

The principal authors of this notice are Danielle Nishida and Ana Guzman of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact John Sweeney at (202) 622-3840 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Guidance Under Section 108(a) Concerning the Exclusion of Section 61(a)(12) Discharge of Indebtedness Income of a Grantor Trust or a Disregarded Entity

REG-154159-09

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the exclusion from gross income under section 108(a) of discharge of indebtedness income of a grantor trust or an entity that is disregarded as an entity separate from its owner. The proposed regulations provide rules regarding the term “taxpayer” for purposes of applying section 108 to discharge of indebtedness income of a grantor trust or a disregarded entity. The proposed regulations affect grantor trusts, disregarded entities, and their owners.

DATES: Written or electronic comments and requests for a public hearing must be received by July 12, 2011.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-154159-09), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-154159-09), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC; or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-154159-09).

FOR FURTHER INFORMATION CONTACT: Bryan A. Rimmke or Benjamin H. Weaver, (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 61(a)(12) of the Internal Revenue Code (the Code) provides that income from the discharge of indebtedness is includable in gross income. However, such income may be excludable from gross income under section 108 in certain circumstances. Section 108(a)(1)(A) and (B) excludes from gross income any amount that would be includable in gross income by reason of the discharge of indebtedness of the taxpayer if the discharge occurs in a Title 11 case or to the extent the taxpayer is insolvent when the discharge occurs. Section 108(d)(1) through (3) provides the meaning of the terms “indebtedness of the taxpayer,” “Title 11 case,” and “insolvent,” for purposes of applying section 108, and each definition uses the term “taxpayer.” Section 7701(a)(14) defines a *taxpayer* as any person subject to any internal revenue tax.

Several types of disregarded entities exist under the Code and regulations. For instance, §301.7701-2(a) of the Procedure and Administration Regulations provides that the term *business entity* includes an entity with a single owner that may be disregarded as an entity separate from its owner under §301.7701-3; an example of a disregarded entity under this provision is a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes. Additionally, some disregarded entities are created by statute; examples of statutory disregarded entities include a corporation that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

The activities of an entity that is a disregarded entity are treated in the same manner as a sole proprietorship, branch, or division of the owner (except for certain employment and excise tax rules). Accordingly, for Federal income tax purposes, all assets, liabilities, and items of income, deduction, and credit of a disregarded entity are treated as assets, liabilities, and such items (as the case may be) of the owner of the disregarded entity.

A *grantor trust* is any portion of a trust that is treated (under subpart E of part I of

subchapter J of chapter 1) as being owned by the grantor or another person. In the case of any grantor trust, items of income, deductions, and credits attributable to the trust are includable in computing the taxable income and credits of the owner.

Explanation of Provisions

The proposed regulations provide that, for purposes of applying section 108(a)(1)(A) and (B) to discharge of indebtedness income of a grantor trust or a disregarded entity, the term *taxpayer*, as used in section 108(a)(1) and (d)(1) through (3), refers to the owner(s) of the grantor trust or disregarded entity. The proposed regulations further provide that grantor trusts and disregarded entities themselves will not be considered owners for this purpose. Finally, the proposed regulations provide that, in the case of a partnership, the owner rules apply at the partner level to the partners of the partnership to whom the discharge of indebtedness income is allocable. Thus, for example, if a partnership holds an interest in a grantor trust or disregarded entity, the applicability of section 108(a)(1)(A) and (B) to discharge of indebtedness income of the grantor trust or disregarded entity is tested by looking to the partners to whom the income is allocable. If any partner is itself a grantor trust or disregarded entity, the applicability of section 108(a)(1)(A) and (B) is determined by looking through such grantor trust or disregarded entity to the ultimate owner(s) of such partner.

Some taxpayers have taken the position that the insolvency exception is available to the extent a grantor trust or disregarded entity is insolvent, even if its owner is not. The IRS and the Treasury Department do not believe this is an appropriate application of the relevant statutory provisions. The proposed regulations clarify that, subject to the special rule for partnerships under section 108(d)(6), the insolvency exception is available only to the extent the owner is insolvent, as owner is determined as described in this preamble.

Some taxpayers have taken the position that the bankruptcy exception is available if a grantor trust or disregarded entity is under the jurisdiction of a bankruptcy court, even if its owner is not. These taxpayer-

ers may argue that because, for Federal income tax purposes, the disregarded entity is disregarded and the “taxpayer” is the owner of the disregarded entity’s assets and liabilities, the taxpayer is properly seen as being subject to the bankruptcy court’s jurisdiction. Under the proposed regulations, it is insufficient for the grantor trust or disregarded entity to be subject to the bankruptcy court’s jurisdiction. The proposed regulations clarify that, subject to the special rule for partnerships under section 108(d)(6), the bankruptcy exception is available only if the owner of the grantor trust or disregarded entity is subject to the bankruptcy court’s jurisdiction, as owner is determined as described in this preamble.

Proposed Effective/Applicability Date

These regulations are proposed to apply to discharge of indebtedness income occurring on or after the date final regulations are published in the **Federal Register**. No inference is intended that the provisions set forth in these proposed regulations are not current law.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic

comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Bryan A. Rimmke and Benjamin H. Weaver, Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the IRS and Treasury Department participated in its development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.108–9 is added to read as follows:

§1.108–9 Application of insolvency and bankruptcy provisions of section 108 to disregarded entities and grantor trusts.

(a) *General rule.* For purposes of applying section 108(a)(1)(A) and (B) to discharge of indebtedness income of a grantor trust or disregarded entity, neither the grantor trust nor the disregarded entity shall be considered to be the “taxpayer,” as that term is used in section 108(a)(1) and (d)(1) through (3). Rather, for purposes of section 108(a)(1) and (d)(1) through (3) and subject to section 108(d)(6), the owner of the grantor trust or disregarded entity is the taxpayer. If indebtedness of a grantor trust or disregarded entity

is discharged in a Title 11 case, section 108(a)(1)(A) will apply only to an owner of the grantor trust or disregarded entity that is under the jurisdiction of the court in a Title 11 case. If the grantor trust or disregarded entity is under the jurisdiction of the court in a Title 11 case, but the owner of the grantor trust or disregarded entity is not, section 108(a)(1)(A) will not apply to the discharge of indebtedness income. If indebtedness of a grantor trust or disregarded entity is otherwise discharged, section 108(a)(1)(B) will apply only to the extent the owner of the grantor trust or disregarded entity is insolvent. If the grantor trust or disregarded entity is insolvent, but the owner of the grantor trust or disregarded entity is not, section 108(a)(1)(B) will not apply to the discharge of indebtedness income.

(b) *Application to partnerships.* Under section 108(d)(6), in the case of a partnership, section 108(a)(1)(A) and (B) applies at the partner level. Accordingly, in the case of a partnership, paragraph (a) of this section applies to the partners of such partnership to whom the discharge of indebtedness income is allocable.

(c) *Definitions—(1) Disregarded entities.* For purposes of this section, a *disregarded entity* is an entity that is disregarded as an entity separate from its owner for Federal income tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes, a corporation that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

(2) *Grantor trust.* For purposes of this section, a *grantor trust* is any portion of a trust that is treated under subpart E of part I of subchapter J of chapter 1 as being owned by the grantor or another person.

(3) *Owner.* Notwithstanding any other provision of this section to the contrary, neither a grantor trust nor a disregarded entity shall be considered an owner for purposes of this section.

(d) *Effective/applicability date.* The rules of this section are proposed to apply to discharge of indebtedness income occurring on or after the date final regulations are published in the Federal Register.

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

(Filed by the Office of the Federal Register on April 12, 2011, 8:45 a.m., and published in the issue of the Federal Register for April 13, 2011, 76 F.R. 20593)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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

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

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