

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2018-45
November 5, 2018

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

Administrative

REV. PROC. 2018-54, page 769.

This revenue procedure provides guidance for taxpayers that hold investments in one or more segregated asset accounts on which variable contracts as defined in section 817 of the Internal Revenue Code are based. The guidance allows taxpayers to elect to treat certain mortgage-backed securities as having deemed issuers for purposes of the diversification requirements of section 817(h).

rate. For purposes of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for November 2018.

REV. RUL. 2018-29, page 765.

This revenue ruling addresses questions on the application to real property of the “original use” requirement in section 1400Z-2(d)(2)(D)(i)(II) and the “substantial improvement” requirement in section 1400Z-2(d)(2)(D)(i)(II) and 1400Z-2(d)(2)(D)(ii). In addition, this revenue ruling provides guidance on the substantial-improvement requirement with respect to a purchased building located in a qualified opportunity zone.

Income Tax

Notice 2018-84, page 768.

Notice 2018-84 provides interim guidance clarifying how the suspension of the personal exemption deduction in § 151(d)(5) of the Tax Cuts and Jobs Act applies to certain rules under §§ 36B and 6011 relating to the premium tax credit, and under § 5000A relating to the individual shared responsibility provision. The notice also announces that the Treasury Department and IRS intend to amend the regulations under §§ 36B and 6011 to clarify the application of § 151(d)(5), and that until further guidance is issued the guidance in the notice applies.

REV. PROC. 2018-54, page 769.

This revenue procedure provides guidance for taxpayers that hold investments in one or more segregated asset accounts on which variable contracts as defined in section 817 of the Internal Revenue Code are based. The guidance allows taxpayers to elect to treat certain mortgage-backed securities as having deemed issuers for purposes of the diversification requirements of section 817(h).

REV. RUL. 2018-28, page 764.

Federal rates; adjusted federal rates; adjusted federal long-term rate, the long-term exempt rate, and the blended annual

The IRS Mission

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

Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

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

Section 1274.—*Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property.* (Also Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520, 7872.)

Rev. Rul. 2018–28

This revenue ruling provides various prescribed rates for federal income tax purposes for November 2018 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable fed-

eral 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 sec-

tion 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2018–28 TABLE 1				
Applicable Federal Rates (AFR) for November 2018				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
		<i>Short-term</i>		
AFR	2.70%	2.68%	2.67%	2.67%
110% AFR	2.97%	2.95%	2.94%	2.93%
120% AFR	3.25%	3.22%	3.21%	3.20%
130% AFR	3.51%	3.48%	3.46%	3.46%
		<i>Mid-term</i>		
AFR	3.04%	3.02%	3.01%	3.00%
110% AFR	3.35%	3.32%	3.31%	3.30%
120% AFR	3.65%	3.62%	3.60%	3.59%
130% AFR	3.97%	3.93%	3.91%	3.90%
150% AFR	4.58%	4.53%	4.50%	4.49%
175% AFR	5.36%	5.29%	5.26%	5.23%
		<i>Long-term</i>		
AFR	3.22%	3.19%	3.18%	3.17%
110% AFR	3.54%	3.51%	3.49%	3.48%
120% AFR	3.87%	3.83%	3.81%	3.80%
130% AFR	4.19%	4.15%	4.13%	4.11%

REV. RUL. 2018–28 TABLE 2				
Adjusted AFR for November 2018				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	2.04%	2.03%	2.02%	2.02%
Mid-term adjusted AFR	2.30%	2.29%	2.28%	2.28%
Long-term adjusted AFR	2.43%	2.42%	2.41%	2.41%

REV. RUL. 2018-28 TABLE 3

Rates Under Section 382 for November 2018

Adjusted federal long-term rate for the current month	2.43%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	2.43%

REV. RUL. 2018-28 TABLE 4

Appropriate Percentages Under Section 42(b)(1) for November 2018

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

Appropriate percentage for the 70% present value low-income housing credit	7.72%
Appropriate percentage for the 30% present value low-income housing credit	3.31%

REV. RUL. 2018-28 TABLE 5

Rate Under Section 7520 for November 2018

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	3.6%
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Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

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 November 2018. See Rev. Rul. 2018-28, page 764.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

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 November 2018. See Rev. Rul. 2018-28, page 764.

Section 7520.—Valuation Tables

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

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

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2018. See Rev. Rul. 2018-28, page 764.

Section 1400Z-2.—Special Rules for Capital Gains Invested in Opportunity Zones

Rev. Rul. 2018-29

ISSUES

(1) If a qualified opportunity fund (QOF), as defined in § 1400Z-2(d)(1) of the Internal Revenue Code (Code), purchases an existing building located on land that is wholly within a qualified opportunity zone (QOZ), as defined in § 1400Z-1, can the original use of the building or the land in the QOZ be considered to have commenced with the QOF?

(2) If a QOF purchases an existing building in a QOZ and the land upon

which the building is located in a QOZ, is a substantial improvement to the building measured by additions to the adjusted basis in the building or is it measured by additions to the adjusted basis in the building and the land?

(3) If a substantial improvement to the building is measured by additions to the QOF's adjusted basis in the building, does § 1400Z-2(d) require the QOF to separately substantially improve the land?

FACTS

In September 2018, QOF A purchases for \$800x Property X, which is located wholly within the boundaries of a QOZ. Property X consists of a building previously used as a factory erected prior to 2018 and land on which the factory building is located. QOF A intends to convert the factory building to residential rental property. Sixty percent (\$480x) of the \$800x purchase price for Property X is attributable to the value of the land and forty percent (\$320x) is attributable to the value of the building. Within 24 months after the date of QOF A's acquisition of Property X, QOF A invests an additional \$400x in converting the building to residential rental property.

LAW AND ANALYSIS

Pursuant to § 1400Z-1(b)(1)(A) of the Code, the Chief Executive Officer of each State nominated a limited number of population census tracts to be designated as QOZs for purposes of §§ 1400Z-1 and 1400Z-2.

Under § 1400Z-2(d)(1), the term "qualified opportunity fund" (QOF) means any investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (Zone Property) (other than another QOF) that holds at least 90 percent of its assets in Zone Property.

Under § 1400Z-2(d)(2)(A), Zone Property means property that is either qualified opportunity zone stock (Zone Stock), qualified opportunity zone partnership interest (Zone Partnership Interest), or qualified opportunity zone business property (Zone Business Property).

Zone Business Property is defined in § 1400Z-2(d)(2)(D). Section 1400Z-2(d)(2)(D)(i) provides that Zone Business

Property is tangible property used in a trade or business of the QOF if (a) such tangible property is purchased by the QOF after December 31, 2017, (b) the original use of such tangible property commences with the QOF or the QOF substantially improves the tangible property, and (c) during substantially all of the QOF's holding period for such tangible property, substantially all of the use of such tangible property is in a QOZ.

Under § 1400Z-2(d)(2)(D)(ii), tangible property used in a QOF's trade or business is treated as substantially improved by the QOF only if, during any 30-month period beginning after the date of acquisition of such tangible property, additions to basis with respect to such tangible property in the hands of the QOF exceed an amount equal to the adjusted basis of such tangible property at the beginning of such 30-month period in the hands of the QOF.

Questions have arisen as to whether for purposes of § 1400Z-2(d)(2)(D)(i) the original use of land in the QOZ can ever be considered to have commenced with a QOF and, therefore, constitute Zone Business Property. In addition, if the original use of land in the QOZ cannot commence with a QOF and if land is treated as property separate from a building for purposes of § 1400Z-2(d), must land be substantially improved in order to qualify as Zone Business Property?

Given the permanence of land, land can never have its original use in a QOZ commencing with a QOF. Section 1400Z-2 seeks to encourage economic growth and investment in the designated QOZs by providing Federal income tax benefits to taxpayers who newly invest in businesses located within these economically distressed communities. Consistent with this intent, a building located on land within a QOZ is treated as substantially improved within the meaning of § 1400Z-2(d)(2)(D)(ii) if, during any 30-month period beginning after the date of acquisition of the building, additions to the taxpayer's basis in the building exceed an amount equal to the taxpayer's adjusted basis of the building at the beginning of such 30-month period. Further, the fact that the cost of the land within the QOZ upon which the building is located is not included in

the taxpayer's adjusted basis in the building does not mean that the taxpayer is required to separately substantially improve such land for it to qualify as Zone Business Property.

Under the facts of this revenue ruling, QOF A purchased Property X, a factory building and the land on which was located (both wholly within a QOZ), for \$800x with the intent to convert the building into residential rental property. Sixty percent (\$480x) of the purchase price for Property X was attributable to the value of the land and forty percent (\$320x) was attributable to the value of the building. Section 1400Z-2(d)(2)(D)(ii) does not apply to the land on which the factory building is located, but does apply to the building. Because the factory building existed on land within the QOZ prior to QOF A's purchase of Property X, the building's original use within the QOZ did not commence with QOF A. However, under § 1400Z-2(d)(2)(D)(ii) QOF A substantially improved Property X because during the 30-month period beginning after the date of QOF A's acquisition of Property X QOF A's additions to the basis of the factory building (\$400x) exceed an amount equal to QOF A's adjusted basis of the building at the beginning of the 30-month period (\$320x). The fact that the cost of the land on which the building is located is not included in QOF A's adjusted basis of the building does not mean that QOF A is required to separately substantially improve the land.

HOLDING

(1) If a QOF purchases an existing building located on land that is wholly within a QOZ, the original use of the building in the QOZ is not considered to have commenced with the QOF for purposes of § 1400Z-2(d)(2)(D)(i), and the requirement under § 1400Z-2(d)(2)(D)(i) that the original use of tangible property in the QOZ commence with a QOF is not applicable to the land on which the building is located.

(2) If a QOF purchases a building wholly within a QOZ, under § 1400Z-2(d)(2)(D)(ii) a substantial improvement to the building is measured by the QOF's additions to the adjusted basis of the building.

(3) Under § 1400Z-2(d), measuring a substantial improvement to the building by additions to the QOF's adjusted basis of the building does not require the QOF to separately substantially improve the land upon which the building is located.

DRAFTING INFORMATION

The principal author of this revenue ruling is Erika C. Reigle of the Office of Associate Chief Counsel Income Tax &

Accounting. For further information regarding this revenue ruling, contact Erika C. Reigle at (202) 317-7006 (not a toll-free number).

Part III. Administrative, Procedural, and Miscellaneous

Guidance under §§ 36B, 5000A, and 6011 on the suspension of personal exemption deductions

Notice 2018–84

PURPOSE

Section 11041 of the Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054, 2082 (the Act), added § 151(d)(5) to the Internal Revenue Code (Code). Section 151(d)(5) reduces the amount of the personal exemption deduction to zero for taxable years beginning after December 31, 2017, and before January 1, 2026. This notice provides interim guidance clarifying how the reduction of the personal exemption deduction to zero in § 151(d)(5) applies for purposes of certain rules under §§ 36B and 6011 relating to the premium tax credit and under § 5000A relating to the individual shared responsibility provision. This notice also announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to amend the regulations under §§ 36B and 6011 to clarify the application of § 151(d)(5). Until further guidance is issued, the interim guidance described in this notice applies for purposes of the regulations under §§ 36B and 5000A and for purposes of § 1.6011–8(a).

BACKGROUND

Section 151 generally allows a taxpayer to claim a personal exemption deduction for the taxpayer, the taxpayer's spouse, and any dependents, based on the exemption amount defined in § 151(d). For tax years prior to 2018, a taxpayer claimed a personal exemption deduction for an individual by putting the individual's name and taxpayer identification number (TIN) on the taxpayer's income tax return, multiplying the number of allowed exemptions by the exemption amount, and entering that amount on the tax return.

Section 11041 of the Act added § 151(d)(5) to the Code. Section 151(d)(5)(A) provides that, for taxable years beginning after December 31, 2017, and before January 1,

2026, the term “exemption amount” means zero. Section 151(d)(5)(B) provides that the reduction of the exemption amount to zero “shall not be taken into account in determining whether a [personal exemption] deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction under this section.” Thus, even though the amount of the personal exemption deduction is reduced to zero, taxpayers are still allowed personal exemption deductions under § 151 for purposes of other provisions of the Code. See H.R. Rep. No. 115–466 at 203 n.16 (Conf. Rep.) (2017) (“The provision [amendments to § 151] also clarifies that, for purposes of taxable years in which the personal exemption is reduced to zero, this should not alter the operation of those provisions of the Code which refer to a taxpayer allowed a deduction (or an individual with respect to whom a taxpayer is allowed a deduction) under section 151.”).

Section 36B allows a premium tax credit to eligible individuals who enroll themselves, their spouse, or any dependent (as defined in § 152) in a qualified health plan through an Exchange, and § 6011 provides general rules related to income tax return filing requirements. The regulations under §§ 36B and 6011 include rules that apply based on whether a taxpayer claims or claimed a personal exemption deduction under § 151 for an individual. These rules affect eligibility for the premium tax credit, computation of the premium tax credit, reconciliation of advance payments of the premium tax credit, and income tax return filing requirements related to the premium tax credit. Specifically, references such as “claim a personal exemption deduction,” “claims a personal exemption deduction,” or “claimed as a personal exemption deduction,” are included in §§ 1.36B–1(d); 1.36B–2(c)(4); 1.36B–4(a)(1)(ii)(B)(1), (a)(1)(ii)(B)(2), (a)(1)(ii)(C), and (a)(4); and § 1.6011–8(a). The Treasury Department and the IRS intend to amend the regulations under §§ 36B and 6011 to clarify the meaning of claiming a personal exemption deduction for the taxable years for which the exemption amount is reduced to zero.

Section 5000A provides that if a taxpayer, or dependent of the taxpayer who is

an applicable individual for whom the taxpayer is liable, is without minimum essential coverage or a coverage exemption for one or more months in a taxable year, the taxpayer must include an individual shared responsibility payment when filing his or her federal income tax return. The regulations under § 5000A include rules that apply based on whether a taxpayer claims or claimed a personal exemption deduction under § 151 for an individual. Specifically, § 1.5000A–1(d)(4) refers to a taxpayer who “claims a deduction for a personal exemption,” and § 1.5000A–3(e)(3)(ii)(B) refers to “an individual for whom a personal exemption deduction . . . is claimed.”

Section 11081 of the Act reduced the amount of the shared responsibility payment to zero for months beginning after December 31, 2018. Accordingly, although this notice provides interim guidance related to § 5000A, the Treasury Department and the IRS do not intend to propose regulations under § 5000A.

INTERIM GUIDANCE

Because the Act reduces the exemption amount to zero, taxpayers will no longer claim a personal exemption deduction on their individual income tax returns by listing an individual's name and TIN, multiplying the number of allowed exemptions by the exemption amount, and entering that amount on their tax return. Accordingly, taxpayers may have questions about what it means to claim a personal exemption deduction for purposes of the premium tax credit and the individual shared responsibility provision. Until further guidance is issued, the following rules apply for purposes of the regulations under §§ 36B and 5000A and for purposes of § 1.6011–8(a):

- (1) A taxpayer is considered to have claimed a personal exemption deduction for himself or herself for a taxable year if the taxpayer files an income tax return for the year and does not qualify as a dependent of another taxpayer under § 152 for the year;
- (2) A taxpayer is considered to have claimed a personal exemption de-

duction for an individual other than the taxpayer if the taxpayer is allowed a personal exemption deduction for the individual (taking into account § 151(d)(5)(B)) and lists the individual's name and TIN on the Form 1040, U.S. Individual Income Tax Return, or Form 1040NR, U.S. Non-resident Alien Income Tax Return, the taxpayer files for the year.

INFERENCE

No inference should be drawn from any provision of this notice concerning any other provision of the Act or any other section of the Code.

EFFECTIVE/APPLICABILITY DATE

This notice applies to taxable years beginning in 2018.

DRAFTING INFORMATION

The principal author of this notice is Lisa Mojiri-Azad of the Office of Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Mojiri-Azad or Steve Toomey at 202-317-4718 (not a toll-free number).

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 817; 1.817-5)

Rev. Proc. 2018-54

SECTION 1. PURPOSE

This revenue procedure provides guidance and procedural rules for taxpayers that hold investments in one or more segregated asset accounts on which variable contracts are based. The guidance and rules allow these taxpayers to elect to treat certain mortgage-backed securities as having deemed issuers for purposes of the diversification requirements of § 817(h) of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 Under the direction of the Federal Housing Finance Agency (FHFA), the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal Na-

tional Mortgage Association (Fannie Mae, and together with Freddie Mac, the GSEs) will develop a common mortgage-backed security (the Single Security Initiative). As part of the Single Security Initiative, key features and terms of Freddie Mac's securities will be aligned with those of Fannie Mae's securities to create new Uniform Mortgage Backed Securities (UMBS). UMBS will be issued by both GSEs with substantially similar terms. UMBS would trade primarily in the "To-Be-Announced" (TBA) market.

.02 Freddie Mac currently issues mortgage-backed securities, called Participation Certificates (PC), to the market. Fannie Mae currently issues similar securities, called Mortgage-Backed Securities (MBS), to the market. PC and MBS are issued under trust agreements and represent undivided beneficial ownership interests in pools of mortgages and related assets held by those trusts (Mortgage Pools). Mortgage servicers perform certain servicing functions for each Mortgage Pool on behalf of the GSE issuer for a fee. Each GSE acts as master servicer and guarantor of the mortgages for a periodic fee.

.03 Today, PC and MBS differ in their respective remittance cycles. Although the remittance cycle for PC is 45 days, the remittance cycle for MBS is 55 days, meaning that an MBS holder receives payments 10 days later than a PC holder.

.04 As part of the Single Security Initiative, the GSEs will combine their fixed-rate PC and MBS programs into a new single mortgage-backed security program in which both GSEs will issue UMBS having substantially similar features and terms, including identical remittance cycles.

.05 Most trading of PC and MBS occurs in the TBA market, which is a forward market in mortgage-backed securities. Today, when counterparties enter into an "unstipulated" TBA trade, they enter into a forward contract that specifies six criteria that the security delivered must satisfy. These six criteria are the coupon, maturity, settlement date, face value, price, and issuer (that is, Freddie Mac or Fannie Mae). Investors may enter into "stipulated" TBA trades to require additional attributes of the security delivered, such as the geographical location of the

underlying mortgages. Once UMBS begin trading in the TBA market, the parameters for unstipulated TBA trades in UMBS will exclude specification of the issuer. As a result, investors that acquire UMBS in unstipulated TBA trades will not know the issuer until the security to be delivered is identified 48 hours prior to settlement.

.06 Section 817(h) provides that for purposes of subchapter L (§§ 801 through 848), § 72 (relating to annuities), and § 7702(a) (relating to the definition of life insurance contract), a variable contract (other than a pension plan contract, as defined in § 818(a)) that is otherwise described in § 817 and that is based on a segregated asset account is not treated as an annuity, endowment, or life insurance contract for any period (and any subsequent period) for which the investments made by the account are not adequately diversified (in accordance with regulations prescribed by the Secretary). *See also* § 1.817-5(a)(1) of the Income Tax Regulations.

.07 As defined in § 1.817-5(e), a segregated asset account consists of all assets the investment return and market value of each of which must be allocated in an identical manner to any variable contract invested in any of such assets. *See also* § 1.817-5(g) (providing examples illustrating the application of the segregated asset account definition).

.08 In current commercial practice, the policyholder of a variable contract may usually select among various investment strategies, each of which results in investment in different portfolios of assets. Each of these portfolios may be a segregated asset account within the meaning of § 1.817-5(e). *See, e.g.*, Rev. Rul. 81-225, 1981-2 C.B. 12, modified by Rev. Proc. 99-44, 1999-2 C.B. 598, clarified and amplified by Rev. Rul. 2007-7, 2007-1 C.B. 468. Each segregated asset account must be adequately diversified within the meaning of § 817(h).

.09 (1) Section 1.817-5(b)(1)(i) provides that the investments of a segregated asset account are considered adequately diversified for purposes of § 1.817-5 and § 817(h) only if no more than—

(A) 55 percent of the value of the total assets of the account is represented by any one investment;

(B) 70 percent of the value of the total assets of the account is represented by any two investments;

(C) 80 percent of the value of the total assets of the account is represented by any three investments; and

(D) 90 percent of the value of the total assets of the account is represented by any four investments.

(2) Section 1.817-5(b)(1)(ii)(A) provides that all securities of the same issuer are treated as a single investment.

(3) Under § 1.817-5(c)(1), an account is treated as adequately diversified for a calendar quarter if it satisfies the requirements of § 1.817-5(b) on the last day of the calendar quarter or within 30 days after that last day.

.10 Section 1.817-5(f)(1) provides a look-through rule for assets held through certain investment companies, partnerships, or trusts. For this purpose, the term “investment company, partnership, or trust” refers to a regulated investment company, a real estate investment trust, a partnership, or a trust that is treated under §§ 671 through 679 as owned by the grantor or another person.

(1) The look-through rule applies to an investment company, partnership, or trust that meets the requirements described in § 1.817-5(f)(2). Section 1.817-5(f)(2) generally requires that all the beneficial interests in such an entity be held by one or more segregated accounts and that public access to such an entity be available exclusively through the purchase of a variable contract.

(2) Section 1.817-5(f)(3) provides limited exceptions to § 1.817-5(f)(2).

.11 If the look-through rule applies, a beneficial interest in an investment company, partnership, or trust is not treated as a single investment of a segregated asset account. Instead, a pro rata portion of each asset of the investment company, partnership, or trust is treated as an asset of the segregated asset account. For purposes of that treatment, the ratable interest of a partner in a partnership’s assets is determined in accordance with the partner’s capital interest in the partnership.

.12 Section 1.817-5(h)(1) defines “government security” as any security issued or guaranteed or insured by the United States or an instrumentality of the United States or any certificate of deposit

for any of the foregoing. (This definition is similar to the language used to define “government security” in § 2(a)(16) of the Investment Company Act of 1940.) For purposes of § 1.817-5(h)(1), “an instrumentality of the United States” means any person that is treated for purposes of 15 U.S.C. 80a-2(16), as amended, as a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States. Under § 817(h)(6), for purposes of determining whether a segregated asset account is adequately diversified, each United States Government agency or instrumentality is treated as a separate issuer. *See also* § 1.817-5(b)(1)(ii)(B).

.13 When a market participant enters into an unstipulated TBA trade to acquire UMBS, it will not know the issuer (Fannie Mae or Freddie Mac) until 48 hours prior to delivery. Thus, suppose that an insurance company enters into unstipulated TBA trades to acquire GSE securities for inclusion in a segregated asset account on which one or more contracts issued by the company are based. Once the Single Security Initiative is effective, such a company will not know until 48 hours before settlement the issuers of the UMBS to be delivered to it under the contract. If the account is already heavily invested in securities issued by one of the GSEs, the TBA contract may require acceptance of additional securities of that issuer—an acceptance that may jeopardize the segregated asset account’s satisfaction of the diversification requirements of § 817(h) and the regulations thereunder.

SECTION 3. DEFINITIONS

Solely for purposes of this revenue procedure—

.01 The term “taxpayer” means—

- (1) An insurance company that issues variable contracts within the meaning of § 817(d); and
- (2) An investment company, partnership, or trust, as defined in section 2.10 of this revenue procedure, that qualifies for “look-through” treatment under § 1.817-5(f).

.02 The term “electing taxpayer” means a taxpayer subject to a deemed-issuance-ratio election as described in this revenue procedure.

.03 The term “generic GSE security” means a TBA-eligible GSE security that a buyer acquires by taking delivery pursuant to a TBA trade in which, at the time that the buyer entered into the TBA contract, the buyer had no way of knowing the actual issuer(s) of the securities to be delivered under the contract.

.04 For purposes of determining whether a security is a generic GSE security, the term “buyer” includes a taxpayer that is either of the following:

(1) An assignee of a buyer (taking into account this section 3.04), provided that—

- a. There is a legal transfer to the assignee of rights and obligations under the assignor’s TBA contract for the acquisition of a generic GSE security; and
- b. This transfer occurs at a time when neither the assignor nor the assignee has any way of knowing the actual issuer(s) of the securities to be delivered under the contract.

(2) A successor entity to a buyer (taking into account this section 3.04), provided that—

- a. The successor entity succeeds to attributes of the buyer in a transaction to which § 381(a) applies;
- b. The buyer to which the successor entity succeeds is an electing taxpayer; and
- c. The successor entity either already is an electing taxpayer or makes a deemed-issuance-ratio election for the first taxable year in which that entity becomes a successor to the buyer.

.05 For purposes of the operation of these definitions, the following rules apply:

(1) The term “generic GSE security” applies to those securities only with respect to a buyer who acquired them in the manner described in section 3.03 or section 3.04 of this revenue procedure. That is, they are not generic GSE securities with respect to any other person.

(2) The term does not include securities acquired in specified pool trades, stipulated trades in which the issuer is stipulated, or any other trade in which the issuer of the security can

be known when the TBA contract is initiated.

SECTION 4. SCOPE

This revenue procedure applies to—

.01 Any taxpayer as defined in section 3.01 of this revenue procedure; and

.02 Any generic GSE security, as defined in section 3.03 of this revenue procedure, with respect to which such a taxpayer is a buyer.

SECTION 5. APPLICATION— ABILITY TO MAKE A DEEMED- ISSUANCE-RATIO ELECTION

A taxpayer may make a deemed-issuance-ratio election with respect to its generic GSE securities. The consequences of a deemed-issuance-ratio election are described in section 6 of this revenue procedure. The required time and manner for making a deemed-issuance-ratio election are described in section 7 of this revenue procedure.

SECTION 6. APPLICATION— CONSEQUENCES OF A DEEMED- ISSUANCE-RATIO ELECTION

.01 For purposes of applying § 817(h) and the regulations thereunder, the consequences described in sections 6.02 through 6.05 of this revenue procedure apply to the extent that an electing taxpayer's generic GSE securities either—

- (1) Are held in a segregated asset account on which a variable contract issued by the taxpayer is based; or
- (2) Are treated under § 1.817-5(f) as being held in a segregated asset account on which a variable contract issued by some other person is based.

.02 (1) If an electing taxpayer holds a generic GSE security, that security is deemed to be issued in part by Fannie Mae and in part by Freddie Mac. Except to the extent provided in section 6.02(2) of this revenue procedure, the portions deemed issued by each are determined by the deemed-issuance ratio that was applicable to the year in which the taxpayer entered into the TBA contract under which the generic GSE security was to be delivered. See section 6.05 of this revenue procedure.

It is irrelevant which GSE is the actual issuer of the generic GSE securities that are delivered under the TBA contract.

(2) In the case of a taxpayer that is a buyer by virtue of section 3.04(2) of this revenue procedure (concerning successor entities), if such a taxpayer acquired a generic GSE security in the succession transaction, then the security retains the same deemed-issuance ratio in that taxpayer's hands that it had in the hands of the predecessor.

(3) *Example.* Assume that an electing taxpayer entered into a TBA contract to acquire \$100x in generic GSE securities to be held in a segregated asset account on which a variable contract issued by the electing taxpayer is based. On the date when the contract was entered, the applicable deemed-issuance ratio (as described in section 6.05 of this revenue procedure) was 60-to-40, Fannie Mae to Freddie Mac. Accordingly, for purposes of applying § 817(h) and the regulations thereunder, any generic GSE security that was delivered under the contract is deemed to have been issued 60 percent by Fannie Mae and 40 percent by Freddie Mac. In the aggregate, therefore, when those generic GSE securities are first acquired, they are treated as \$60x Fannie Mae securities and \$40x Freddie Mac securities, regardless of which GSE is the actual issuer of the generic GSE securities that are delivered under the TBA contract.

.03 As long as the electing taxpayer continues to hold a generic GSE security, the security's deemed-issuance ratio remains constant. Thus—

- (1) As an electing taxpayer's generic GSE securities pay down, the remaining balance of each retains its deemed-issuance ratio, regardless of any pre-payments or foreclosures made on the generic GSE securities and the actual issuers of remaining generic GSE securities.
- (2) If the electing taxpayer disposes of some of its generic GSE securities, the deemed-issuance ratio of each

remaining generic GSE security does not vary.

.04 If a generic GSE security held by an electing taxpayer is aggregated into a pool of mortgage-backed securities as part of a GSE resecuritization program and new securities are issued, then the issuer of the new security is the known GSE that issued the resecuritization security, and the deemed-issuance ratio no longer applies to the old security in its role as a component of the resecuritization pool. To the extent a new resecuritization security is delivered into a generic TBA trade (with the issuer unknown by the taxpayer at the trade date), a taxpayer that has made a deemed-issuance-ratio election treats the resecuritization security consistent with the deemed-issuance rule.

.05 At least three weeks prior to the start of each calendar year, FHFA will determine and publicize the deemed-issuance ratio that electing taxpayers are to use for TBA contracts entered into during that calendar year.

(1) FHFA will determine this ratio based on the ratio of TBA-eligible securities issued by Fannie Mae and Freddie Mac during a 24-month period ending not earlier than October 31 immediately preceding the year to which the new ratio will apply. The ratio must be two whole numbers. FHFA may round the observed ratio in the data to whatever extent FHFA considers appropriate, provided that the rounded ratio to be used is further from 50-50 than the actual observed data.

(2) *Example.* At least three weeks prior to the start of 2019, FHFA will determine and publicize the deemed-issuance ratio that electing taxpayers are to use for TBA contracts to acquire generic GSE securities entered into during 2019. FHFA will determine this ratio based on the ratio of TBA-eligible securities issued by Fannie Mae and Freddie Mac during the 24-month period ending not earlier than October 31, 2018. If the percent of aggregate TBA-eligible securities issued by Fannie Mae and Freddie Mac during the 24-month period ending on October 31, 2018, was 59 percent and 41 percent respectively, then FHFA might deter-

mine a deemed-issuance ratio of 60-to-40, Fannie Mae-to-Freddie Mac. If it did so, then solely for purposes of determining whether electing taxpayers' segregated asset accounts meet the diversification requirements of § 817(h), that deemed-issuance ratio would apply to any generic GSE security delivered under a TBA contract that is entered into during 2019, regardless of the actual issuers of the delivered securities.

SECTION 7. PROCEDURE—MAKING THE ELECTION

.01 A deemed-issuance-ratio election must be made in a statement attached to the taxpayer's income tax return for the first taxable year for which the taxpayer wants the election to apply. The statement must be titled "Section 817(h) Deemed-Issuance-Ratio Election." The statement must indicate that the taxpayer elects the deemed-issuance-ratio election (as described in this revenue procedure) and must include the taxpayer's name, address, and TIN. If the common parent (or agent within the meaning of § 1.1502-77) of a group of corporations filing a consolidated return is making the election on behalf of one or more members of the consolidated group, the parent must indicate the name, address, and taxpayer identification number of each consolidated group member for which the election is being made.

.02 A deemed-issuance-ratio election is applicable to all of the electing taxpayer's generic GSE securities acquired under

TBA contracts that were entered into for quarters ending in the year specified in the election and for quarters ending in all subsequent taxable years for which the election is effective.

.03 A deemed-issuance-ratio election is revocable only with the prior written consent of the Commissioner of Internal Revenue. To request the Commissioner's consent, the electing taxpayer (or successor) must submit a request for a private letter ruling in accordance with the provisions of Rev. Proc. 2018-1, 2018-1 I.R.B. 1 (or its then-applicable successor).

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for elections with respect to quarters ending on or after the date on which investors can first enter into TBA contracts that do not specify the issuer of the GSE securities that may be delivered under it.

SECTION 9. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been approved by the Office of Management and Budget (OMB) under OMB control number 1545-0123 in accordance with the Paperwork Reduction Act (44 U.S.C. 3507). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

This revenue procedure contains a collection of information requirement in section 7. The purpose of the collection of information is to verify the taxpayer's deemed-issuance-ratio election. The col-

lection of information is required to obtain the benefit of using the election. The likely respondents are taxpayers (as defined in section 3.01 of this revenue procedure) that hold investments in one or more segregated asset accounts on which variable contracts are based.

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

SECTION 10. DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, please contact Katherine A. Hossofsky at (202) 317-6995 (not a toll-free number).

Section 817—Treatment of variable contracts

26 CFR 1.817-5: Diversification requirements for variable annuity, endowment, and life insurance contracts.

This revenue procedure provides guidance for taxpayers that hold investments in one or more segregated asset accounts on which variable contracts as defined in section 817 of the Internal Revenue Code. The guidance allows taxpayers to elect to treat certain mortgage-backed securities as having deemed issuers for purposes of the diversification requirements of section 817(h). See Rev. Proc. 2018-54, page 769.

Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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

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

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¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–01 through 2018–26 is in Internal Revenue Bulletin 2018–26, dated June 27, 2018.

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¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–01 through 2018–26 is in Internal Revenue Bulletin 2018–26, dated June 27, 2018.

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