INTERNAL REVENUE
BULLETIN

Bulletin No. 2019–44
October 28, 2019

HIGHLIGHTS OF THIS ISSUE

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

ADMINISTRATIVE

Rev. Proc. 2019-41, page 1022.

This procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under section 42(h)(3)(D) of the Code for calendar year 2019.

EXEMPT ORGANIZATIONS

REG-128246-18, page 1037.

This document contains proposed regulations related to the Internal Revenue Code (Code), which allows a State (or its agency or instrumentality) to establish and maintain a tax-advantaged savings program under which contributions may be made to an ABLE account for the purpose of paying for the qualified disability expenses of the designated beneficiary of the account. The affected Code section was amended by the Tax Cuts and Jobs Act, signed into law on December 22, 2017. The Tax Cuts and Jobs Act allows certain designated beneficiaries to contribute a limited amount of compensation income to their own ABLE accounts.

INCOME TAX

Notice 2019-58, page 1022.

This notice announces that, following the expiration of the temporary regulations under section 385, taxpayers may rely on the notice of proposed rulemaking cross-referencing the temporary regulations.

REG-118784-18, page 1024.

The proposed regulations provide guidance on the tax consequences of the phased elimination of interbank offered rates (IBORs) that is expected to occur in the United States and many foreign countries. The proposed regulations generally provide that modifying a debt instrument, derivative, or other contract to replace an IBOR-referencing rate (or to revise fallback provisions in anticipation of the elimination of an IBOR) is not treated as a realization event for purposes of section 1001. The proposed regulations also adjust other tax rules, such as the OID and REMIC rules, to minimize the collateral consequences of the elimination of IBORs.

Rev. Rul. 2019-24, page 1004.

This Revenue Ruling provides guidance on the tax treatment of virtual currency hard forks. This Revenue Ruling provides that a hard fork not followed by an airdrop of units of a new cryptocurrency does not result in gross income to owners of the original cryptocurrency. This Revenue Ruling further provides that a hard fork followed by an airdrop of units of a new cryptocurrency results in gross income to the recipients of units of new cryptocurrency from the airdrop.

T.D. 9876, page 1005.

This document contains final regulations concerning how partnership liabilities are allocated for disguised sale purposes. The regulations replace existing temporary regulations with final regulations that were in effect prior to the temporary regulations. These regulations affect partnerships and their partners.

T.D. 9877, page 1007.

This document contains final regulations addressing when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704 of the Internal Revenue Code (Code), when partnership liabilities are treated as recourse liabilities under section 752, and how bottom dollar payment obligations are treated under section 752. These final regulations provide guidance necessary for a partnership to allocate its liabilities among its partners. These regulations affect partnerships and their partners.

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 enforce the law with integrity and fairness to all.

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

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

Part I

26 CFR 1.61-1: Gross income.
(Also §§ 61, 451, 1011.)

Rev. Rul. 2019-24

ISSUES

(1) Does a taxpayer have gross income under § 61 of the Internal Revenue Code (Code) as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency?

(2) Does a taxpayer have gross income under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency?

BACKGROUND

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value other than a representation of the United States dollar or a foreign currency. Foreign currency is the coin and paper money of a country other than the United States that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance. *See* 31 C.F.R. § 1010.100(m).

Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of cryptocurrency are generally referred to as coins or tokens. Distributed ledger technology uses independent digital systems to record, share, and synchronize transactions, the details of which are recorded in multiple places at the same time with no central data store or administration functionality.

A hard fork is unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. Following a hard fork, transactions involving the new cryptocurrency are recorded on the new distributed ledger and transactions involving the legacy cryptocurrency continue to be recorded on the legacy distributed ledger.

An airdrop is a means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple taxpayers. A hard fork followed by an airdrop results in the distribution of units of the new cryptocurrency to addresses containing the legacy cryptocurrency. However, a hard fork is not always followed by an airdrop.

Cryptocurrency from an airdrop generally is received on the date and at the time it is recorded on the distributed ledger. However, a taxpayer may constructively receive cryptocurrency prior to the airdrop being recorded on the distributed ledger. A taxpayer does not have receipt of cryptocurrency when the airdrop is recorded on the distributed ledger if the taxpayer is not able to exercise dominion and control over the cryptocurrency. For example, a taxpayer does not have dominion and control if the address to which the cryptocurrency is airdropped is contained in a wallet managed through a cryptocurrency exchange and the cryptocurrency exchange does not support the newly-created cryptocurrency such that the airdropped cryptocurrency is not immediately credited to the taxpayer's account at the cryptocurrency exchange. If the taxpayer later acquires the ability to transfer, sell, exchange, or otherwise dispose of the cryptocurrency, the taxpayer is treated as receiving the cryptocurrency at that time.

FACTS

Situation 1: *A* holds 50 units of *Crypto M*, a cryptocurrency. On *Date 1*, the distributed ledger for *Crypto M* experiences a hard fork, resulting in the creation of *Crypto N*. *Crypto N* is not airdropped or otherwise transferred to an account owned or controlled by *A*.

Situation 2: *B* holds 50 units of *Crypto R*, a cryptocurrency. On *Date 2*, the distributed ledger for *Crypto R* experiences a hard fork, resulting in the creation of *Crypto S*. On that date, 25 units of *Crypto S* are airdropped to *B*'s distributed ledger address and *B* has the ability to dispose of *Crypto S* immediately following the airdrop. *B* now holds 50 units of *Crypto R* and 25 units of *Crypto S*. The airdrop of *Crypto S* is recorded on the distributed ledger on *Date 2* at *Time 1* and, at that date and time, the fair market value of *B*'s 25 units of *Crypto S* is $50. *B* receives the *Crypto S* solely because *B* owns *Crypto R* at the time of the hard fork. After the airdrop, transactions involving *Crypto S* are recorded on the new distributed ledger and transactions involving *Crypto R* continue to be recorded on the legacy distributed ledger.

LAW AND ANALYSIS

Section 61(a)(3) provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including gains from dealings in property. Under § 61, all gains or undeniable accessions to wealth, clearly realized, over which a taxpayer has complete dominion, are included in gross income. *See Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). In general, income is ordinary unless it is gain from the sale or exchange of a capital asset or a special rule applies. *See*, *e.g.*, §§ 1222, 1231, 1234A.

Section 1011 of the Code provides that a taxpayer's adjusted basis for determining the gain or loss from the sale or exchange of property is the cost or other basis determined under § 1012 of the Code, adjusted to the extent provided under § 1016 of the Code. When a taxpayer receives property that is not purchased, unless otherwise provided in the Code, the taxpayer's basis in the property received is determined by reference to the amount included in gross income, which is the fair market value of the property when the property is received. *See generally* §§ 61 and 1011; *see also* § 1.61-2(d)(2)(i).

Section 451 of the Code provides that a taxpayer using the cash method of accounting includes an amount in gross income in the taxable year it is actually or constructively received. *See* §§ 1.451-1 and 1.451-2. A taxpayer using an accrual method of accounting generally includes an amount in gross income no later than the taxable year in which all the events have occurred which fix the right to receive such amount. *See* § 451.

Situation 1: *A* did not receive units of the new cryptocurrency, Crypto N, from the hard fork; therefore, *A* does not have an accession to wealth and does not have gross income under § 61 as a result of the hard fork.

Situation 2: *B* received a new asset, *Crypto S*, in the airdrop following the hard fork; therefore, *B* has an accession to wealth and has ordinary income in the taxable year in which the *Crypto S* is received. *See* §§ 61 and 451. *B* has dominion and control of *Crypto S* at the time of the airdrop, when it is recorded on the distributed ledger, because *B* immediately has the ability to dispose of *Crypto S*. The amount included in gross income is $50, the fair market value of B's 25 units of *Crypto S* when the airdrop is recorded on the distributed ledger. *B*'s basis in *Crypto S* is $50, the amount of income recognized. *See* §§ 61, 1011, and 1.61-2(d)(2)(i).

HOLDINGS

(1) A taxpayer does not have gross income under § 61 as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency.

(2) A taxpayer has gross income, ordinary in character, under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency.

DRAFTING INFORMATION

The principal author of this revenue ruling is Suzanne R. Sinno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding the revenue ruling, contact Ms. Sinno at (202) 317-4718 (not a toll-free number).

T.D. 9876

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Removal of Temporary Regulations on a Partner's Share of a Partnership Liability for Disguised Sale Purposes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations concerning how partnership liabilities are allocated for disguised sale purposes. The regulations replace existing temporary regulations with final regulations that were in effect prior to the temporary regulations. These regulations affect partnerships and their partners.

DATES: *Effective date*: These regulations are effective on November 8, 2019.

Applicability date: For date of applicability, see §1.707-9(a)(4).

FOR FURTHER INFORMATION CONTACT: Caroline E. Hay at (202) 317-5279 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 707 of the Internal Revenue Code (Code) regarding allocations of partnership liabilities for disguised sale purposes. Section 707(a)(2)(B) generally provides that, under regulations prescribed by the Secretary, related transfers of money or other property to and by a partnership that, when viewed together, are more properly characterized as a sale or exchange of property, will be treated either as a transaction between the partnership and one who is not a partner or between two or more partners acting other than in their capacity as partners (generally referred to as "disguised sales").

On April 21, 2017, the President issued Executive Order 13789 (E.O. 13789), "Executive Order on Identifying and Reducing Tax Regulatory Burdens" (82 FR 19317, April 26, 2017), which directed the Secretary to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate certain burdens imposed by the regulations. In response to E.O. 13789, the Secretary issued an interim report which identified the final and temporary regulations (T.D. 9788) (707 Temporary Regulations) concerning the allocation of partnership liabilities for section 707 purposes as meeting some of the regulatory burdens specified in E.O. 13789, and later issued a second report recommending specific actions to mitigate the burdens. See Notice 2017-38 (2017-30 IRB 147 (July 24, 2017)) and Second Report to the President on Identifying and Reducing Tax Regulatory Burdens (82 FR 48013, October 16, 2017).

Following the issuance of the interim and second reports, on June 19, 2018, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG-131186-17) in the **Federal Register** (83 FR 28397) (2018 Proposed Regulations) proposing to withdraw the 707 Temporary Regulations. The 2018 Proposed Regulations also proposed reinstating the regulations under §1.707-5(a)(2) as in effect prior to the 707 Temporary Regulations and as contained in 26 CFR part 1 revised as of April 1, 2016 (Prior 707 Regulations). Finally, the 2018 Proposed Regulations withdrew a notice of proposed rulemaking (REG-122855-15) that incorporated by cross reference the 707 Temporary Regulations. The Treasury Department and the IRS did not receive any written public comments in response to the 2018 Proposed Regulations. A scheduled public hearing on the 2018 Proposed Regulations was cancelled because no one requested to speak.

Therefore, the 2018 Proposed Regulations proposing to withdraw the 707

Temporary Regulations and reinstate the Prior 707 Regulations are adopted by this Treasury decision without change, except the applicability date has been revised. To avoid a lapse in rules for allocating partnership liabilities for disguised sale purposes, these final regulations apply to any transaction with respect to which all transfers occur on or after October 4, 2019, the date that the 707 Temporary Regulations expire. Preventing a lapse in rules benefits the Treasury Department, the IRS, and taxpayers by providing certainty regarding the applicable rules. These final regulations continue to provide that partnerships and their partners may apply these regulations to any transaction with respect to which all transfers occur on or after January 3, 2017, the applicability date of the 707 Temporary Regulations.

Special Analyses

These final regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. Because these final 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, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Ongoing Study of Liability Rule for Disguised Sales

The 707 Temporary Regulations withdrawn by this Treasury decision adopted an approach requiring a partnership to apply the same percentage used to determine a partner's share of excess nonrecourse liabilities under §1.752-3(a)(3) (with certain limitations) in determining the partner's share of all partnership liabilities for disguised sale purposes. As was noted in the preamble to the 2018 Proposed Regulations, some commenters supported this approach, but also expressed concern that it was adopted in temporary regulations rather than proposed regulations that would allow for further comment. The Treasury Department and the IRS continue to study the merits of the approach in the 707 Temporary Regulations and other approaches, including these final regulations, to determine which results in the most appropriate treatment of liabilities in the context of disguised sales.

Drafting Information

The principal author of these regulations is Deane M. Burke, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income Taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.707-5 is amended by:

1. Revising paragraph (a)(2).
2. Designating *Examples 1* through *13* of paragraph (f) as paragraphs (f)(1) through (f)(13), respectively.
3. Revising newly designated paragraphs (f)(2) and (3).
4. Removing the language "*Example 5*" in newly designated paragraphs (f)(6)(i) and (ii) and adding the language "paragraph (f)(5) of this section (*Example 5*)" in its place.
5. Revising newly designated paragraphs (f)(7) and (8).
6. Removing the language "*Example 10*" in newly designated paragraph (f)(11)(i) and adding the language "paragraph (f)(10) of this section (*Example 10*)" in its place.

The revisions read as follows:

§1.707-5 Disguised sales of property to partnership; special rules relating to liabilities.

(a) * * *

(2) *Partner's share of liability*. A partner's share of any liability of the partnership is determined under the following rules:

(i) *Recourse liability*. A partner's share of a recourse liability of the partnership equals the partner's share of the liability under the rules of section 752 and the regulations in this part under section 752. A partnership liability is a recourse liability to the extent that the obligation is a recourse liability under §1.752-1(a)(1) or would be treated as a recourse liability under that section if it were treated as a partnership liability for purposes of that section.

(ii) *Nonrecourse liability*. A partner's share of a nonrecourse liability of the partnership is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under §1.752-3(a)(3). A partnership liability is a nonrecourse liability of the partnership to the extent that the obligation is a nonrecourse liability under §1.752-1(a)(2) or would be a nonrecourse liability of the partnership under §1.752-1(a)(2) if it were treated as a partnership liability for purposes of that section.

* * * * *

(f) * * *

(2) *Example 2. Partnership's assumption of recourse liability encumbering transferred property*. (i) C transfers property Y to a partnership. At the time of its transfer to the partnership, property Y has a fair market value of $10,000,000 and is subject to an $8,000,000 liability that C incurred, immediately before transferring property Y to the partnership, in order to finance other expenditures. Upon the transfer of property Y to the partnership, the partnership assumed the liability encumbering that property. The partnership assumed this liability solely to acquire property Y. Under section 752 and the regulations in this part under section 752, immediately after the partnership's assumption of the liability encumbering property Y, the liability is a recourse liability of the partnership and C's share of that liability is $7,000,000.

(ii) Under the facts of paragraph (f)(2)(i) of this section (*Example 2*), the liability encumbering property Y is not a qualified liability. Accordingly, the partnership's assumption of the liability results in a transfer of consideration to C in connection with C's transfer of property Y to the partnership in the amount of $1,000,000 (the excess of the liability assumed by the partnership ($8,000,000) over C's share of the liability immediately after the assumption ($7,000,000)). See paragraphs (a)(1) and (2) of this section.

(3) *Example 3. Subsequent reduction of transferring partner's share of liability*. (i) The facts are the same as in paragraph (f)(2) of this section (*Example 2*). In addition, property Y is a fully leased office building, the rental income from property Y is sufficient to meet debt service, and the remaining term of the liability is ten years. It is anticipated that, three years after the partnership's assumption of the liability, C's share of the liability under section 752 will be reduced to zero because of a shift in the allocation of partnership losses pursuant to the terms of the partnership agreement. Under the partnership agreement, this shift in the allocation of partnership losses is dependent solely on the passage of time.

(ii) Under paragraph (a)(3) of this section, if the reduction in C's share of the liability was anticipated at the time of C's transfer, was not subject to the entrepreneurial risks of partnership operations, and was part of a plan that has as one of its principal purposes minimizing the extent of sale treatment under §1.707-3 (that is, a principal purpose of allocating a large percentage of losses to C in the first three years when losses were not likely to be realized was to minimize the extent to which C's transfer would be treated as part of a sale), C's share of the liability immediately after the assumption is treated as equal to C's reduced share.

* * * * *

(7) *Example 7. Partnership's assumptions of liabilities encumbering properties transferred pursuant to a plan*. (i) Pursuant to a plan, G and H transfer property 1 and property 2, respectively, to an existing partnership in exchange for interests in the partnership. At the time the properties are transferred to the partnership, property 1 has a fair market value of $10,000 and an adjusted tax basis of $6,000, and property 2 has a fair market value of $10,000 and an adjusted tax basis of $4,000. At the time properties 1 and 2 are transferred to the partnership, a $6,000 nonrecourse liability (liability 1) is secured by property 1 and a $7,000 recourse liability of F (liability 2) is secured by property 2. Properties 1 and 2 are transferred to the partnership, and the partnership takes subject to liability 1 and assumes liability 2. G and H incurred liabilities 1 and 2 immediately prior to transferring properties 1 and 2 to the partnership and used the proceeds for personal expenditures. The liabilities are not qualified liabilities. Assume that G and H are each allocated $2,000 of liability 1 in accordance with paragraph (a)(2)(ii) of this section (which determines a partner's share of a nonrecourse liability). Assume further that G's share of liability 2 is $3,500 and H's share is $0 in accordance with paragraph (a)(2)(i) of this section (which determines a partner's share of a recourse liability).

(ii) G and H transferred properties 1 and 2 to the partnership pursuant to a plan. Accordingly, the partnership's taking subject to liability 1 is treated as a transfer of only $500 of consideration to G (the amount by which liability 1 ($6,000) exceeds G's share of liabilities 1 and 2 ($5,500)), and the partnership's assumption of liability 2 is treated as a transfer of only $5,000 of consideration to H (the amount by which liability 2 ($7,000) exceeds H's share of liabilities 1 and 2 ($2,000)). G is treated under the rule in §1.707-3 as having sold $500 of the fair market value of property 1 in exchange for the partnership's taking subject to liability 1 and H is treated as having sold $5,000 of the fair market value of property 2 in exchange for the assumption of liability 2.

(8) *Example 8. Partnership's assumption of liability pursuant to a plan to avoid sale treatment of partnership assumption of another liability*. (i) The facts are the same as in paragraph (f)(7) of this section (*Example 7*), except that—

(A) H transferred the proceeds of liability 2 to the partnership; and

(B) H incurred liability 2 in an attempt to reduce the extent to which the partnership's taking subject to liability 1 would be treated as a transfer of consideration to G (and thereby reduce the portion of G's transfer of property 1 to the partnership that would be treated as part of a sale).

(ii) Because the partnership assumed liability 2 with a principal purpose of reducing the extent to which the partnership's taking subject to liability 1 would be treated as a transfer of consideration to G, liability 2 is ignored in applying paragraph (a)(3) of this section. Accordingly, the partnership's taking subject to liability 1 is treated as a transfer of $4,000 of consideration to G (the amount by which liability 1 ($6,000) exceeds G's share of liability 1 ($2,000)). On the other hand, the partnership's assumption of liability 2 is not treated as a transfer of any consideration to H because H's share of that liability equals $7,000 as a result of H's transfer of $7,000 in money to the partnership.

* * * * *

§1.707-5T [Removed]

Par. 3. Section 1.707-5T is removed.

Par. 4. Section 1.707-9 is amended by revising paragraph (a)(4) and removing paragraph (a)(5). The revision reads as follows:

§1.707-9 Effective dates and transitional rules.

(a) * * *

(4) *Applicability date of §1.707-5(a)(2) and (f)(2), (3), (7), and (8)*. (i) Section 1.707-5(a)(2) and (f)(2), (3), (7), and (8) apply to any transaction with respect to which all transfers occur on or after October 4, 2019. However, a partnership and its partners may apply §1.707-5(a)(2) and (f)(2), (3), (7), and (8) to any transaction with respect to which all transfers occur on or after January 3, 2017.

(ii) For any transaction with respect to which any transfers occur before January 3, 2017, §1.707-5(a)(2) and (f), as contained in 26 CFR part 1 revised as of April 1, 2016, apply.

(iii) For any transaction with respect to which all transfers occur on or after January 3, 2017, and any of such transfers occurs before October 4, 2019, see §1.707-9T(a)(5) as contained in 26 CFR part 1 revised as of April 1, 2019.

* * * * *

§1.707-9T [Removed]

Par. 5. Section 1.707-9T is removed.

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

Approved: October 1, 2010

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

(Filed by the Office of the Federal Register on October 4, 2019, 4:15 p.m., and published in the issue of the Federal Register for October 9, 2019, 84 F.R. 54027)

T.D. 9877

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Liabilities Recognized as Recourse Partnership Liabilities under Section 752

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations addressing when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704 of the Internal Revenue Code (Code), when partnership liabilities are treated as recourse liabilities under section 752, and how bottom dollar

payment obligations are treated under section 752. These final regulations provide guidance necessary for a partnership to allocate its liabilities among its partners. These regulations affect partnerships and their partners.

DATES: *Effective date*: These regulations are effective on October 9, 2019.

Applicability dates: For dates of applicability, see §§1.704-1(b)(1)(ii)(*a*), 1.752-1(d)(2), and 1.752-2(l).

FOR FURTHER INFORMATION CONTACT: Caroline E. Hay at (202) 317-5279 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

1. *Overview*

This Treasury decision contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 704 and 752 of the Code. On January 30, 2014, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking in the **Federal Register** (REG-119305-11, 79 FR 4826) to amend the then existing regulations under section 707 relating to disguised sales of property to or by a partnership and under section 752 concerning the treatment of partnership liabilities (2014 Proposed Regulations). The 2014 Proposed Regulations provided certain technical rules intended to clarify the application of the disguised sale rules under section 707 and also contained rules regarding the sharing of partnership recourse and nonrecourse liabilities under section 752.

A public hearing on the 2014 Proposed Regulations was not requested or held, but the Treasury Department and the IRS received written comments. On October 5, 2016, after consideration of, and in response to, the comments on the 2014 Proposed Regulations, the Treasury Department and the IRS published in the **Federal Register** (81 FR 69291) final regulations under section 707 concerning disguised sales and under section 752 regarding the allocation of excess nonrecourse liabilities of a partnership to a partner for disguised sale purposes (T.D. 9787). Also on October 5, 2016, the Treasury Department and the IRS published in the **Federal Register** (81 FR 69282) final and temporary regulations under sections 707 and 752 (T.D. 9788) implementing a new rule concerning the allocation of liabilities for section 707 purposes (707 Temporary Regulations) and rules concerning the treatment of "bottom dollar payment obligations" (752 Temporary Regulations). Finally, in the **Federal Register** (81 FR 69301) on October 5, 2016, the Treasury Department and the IRS withdrew the 2014 Proposed Regulations under §1.752-2 and published new proposed regulations (REG-122855-15) cross-referencing the 707 Temporary Regulations (707 Proposed Regulations) and the 752 Temporary Regulations and addressing (1) when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704, and (2) when partnership liabilities are treated as recourse liabilities under section 752 (752 Proposed Regulations). On November 17, 2016, the Treasury Department and the IRS published in the **Federal Register** (81 FR 80993 and 81 FR 80994) two correcting amendments to T.D. 9788 (the temporary regulations as so corrected, 707 Temporary Regulations).

In the **Federal Register** (83 FR 28397) on June 19, 2018, the Treasury Department and the IRS subsequently withdrew the 707 Proposed Regulations, and published proposed regulations (REG-131186-17) proposing to reinstate the regulations under section 707 concerning how partnership liabilities are allocated for disguised sale purposes that were in effect prior to the 707 Temporary Regulations. In addition to these final regulations under sections 704 and 752, the Treasury Department and the IRS are publishing in this issue of the **Federal Register** final regulations under section 707 (T.D. 9876) that are the same as the regulations that were in effect prior to the 707 Temporary Regulations.

A public hearing on the 752 Proposed Regulations was not requested or held, but the Treasury Department and the IRS received written comments. After consideration of the comments, this Treasury decision adopts the rules in the 752 Temporary Regulations and the 752 Proposed Regulations with some changes. These changes, and comments received on the 752 Temporary Regulations and the 752 Proposed Regulations, are discussed in the Summary of Comments and Explanations of Revisions section of the preamble that follows.

2. *Summary of Applicable Law*

Section 752 separates partnership liabilities into two categories: recourse liabilities and nonrecourse liabilities. Section 1.752-1(a)(1) provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss (EROL) for that liability under §1.752-2. Section 1.752-1(a)(2) provides that a partnership liability is a nonrecourse liability to the extent that no partner or related person bears the EROL for that liability under §1.752-2.

A partner generally bears the EROL for a partnership liability if the partner or related person has an obligation to make a payment to any person within the meaning of §1.752-2(b). For purposes of determining the extent to which a partner or related person has an obligation to make a payment, an obligation to restore a deficit capital account upon liquidation of the partnership under the section 704(b) regulations is taken into account (deficit restoration obligation). Further, for this purpose, §1.752-2(b)(6) of the existing regulations presumes that partners and related persons who have payment obligations actually perform those obligations, irrespective of their net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation (the satisfaction presumption). However, the satisfaction presumption is subject to an anti-abuse rule in §1.752-2(j) pursuant to which a payment obligation of a partner or related person may be disregarded or treated as an obligation of another person if facts and circumstances indicate that a principal purpose of the arrangement is to eliminate the partner's EROL with respect to that obligation or create the appearance of the partner or related person bearing the EROL when the substance is otherwise. Under the existing rules, the satisfaction presumption is also subject to a disregarded entity net value requirement under §1.752-2(k) pursuant to which, for purposes of determining the extent to which a partner bears the EROL for a partnership liability, a payment obligation of a disregarded entity is taken into account only to the extent of the net value of the disregarded entity as of the allocation date that is allocated to the partnership liability.

Summary of Comments and Explanations of Revisions

1. *Bottom Dollar Payment Obligations*

A. *Obligations treated as bottom dollar payment obligations*

The 752 Temporary Regulations provide that a bottom dollar payment obligation is not recognized as a payment obligation for purposes of §1.752-2. The 752 Temporary Regulations provide that a bottom dollar payment obligation is the same as or similar to one of the following three types of payment obligations or arrangements: (1) with respect to a guarantee or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation if, and to the extent that, any amount of the partnership liability is not otherwise satisfied; (2) with respect to an indemnity or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation, if, and to the extent that, any amount of the indemnitee's or benefited party's payment obligation is recognized; and (3) an arrangement with respect to a partnership liability that uses tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements to convert what would otherwise be a single liability into multiple liabilities if, based on the facts and circumstances, the liabilities were incurred pursuant to a common plan, as part of a single transaction or arrangement, or as part of a series of related transactions or arrangements, and with a principal purpose of avoiding having at least one of such liabilities or payment obligations with respect to such liabilities being treated as a bottom dollar payment obligation. A payment obligation is not a bottom dollar payment obligation merely because a maximum amount is placed on the partner's or related person's payment obligation, a partner's or related person's payment obligation is stated as a fixed percentage of every dollar of the partnership liability, or there is a right of proportionate contribution running between partners or related persons who are co-obligors with respect to a payment obligation for which each of them is jointly and severally liable. The 752 Temporary Regulations also provide an exception to the non-recognition rule of bottom dollar payment obligations. That is, a bottom dollar payment obligation is recognized when a partner or related person is liable for at least 90 percent of the partner's or related person's initial payment obligation despite an indemnity, a reimbursement agreement, or a similar arrangement.

One commenter stated that the 752 Temporary Regulations are conceptually flawed, result in inconsistent answers, and are directly contrary to Congressional intent. That commenter explained that the prior regulations appropriately followed Congress's mandate that debt is allocated by a partnership to the partners who bear the EROL with respect to the debt. See Section 79 of the Deficit Reduction Act of 1984 (Pub. L. No. 98-369) overruling the decision in *Raphan v. United States*, 3 Cl. Ct. 457 (1983) (holding that a guarantee on a partnership liability by a general partner did not require that partner to be treated as personally liable for that liability and did not preclude the other partners who did not guarantee the loan from sharing in the step up in basis on account of the debt). The commenter argued that the 752 Temporary Regulations instead treat all guarantees as bottom dollar payment obligations which do not create EROL unless the partner is liable for the full amount of that partner's or related person's payment obligation if, and to the extent that, any amount of the partnership liability is not otherwise satisfied. The commenter asserted that, under the 752 Temporary Regulations, all guarantees below 90 percent of a payment obligation are ignored, even if the partnership and the partners believe that the guaranteeing partner bears the EROL with respect to the payment obligation.

As an example of these concerns, the commenter pointed to the different results in *Examples 10* and *11* in §1.752-2T(f). In *Examples 10* and *11*, A, B, and C are equal members of a partnership, ABC. ABC borrows $1,000 from Bank. In *Example 10*, A guarantees up to $300 of the liability if any amount of the $1,000 liability is not recovered by Bank, while B guarantees payment of up to $200, but only if Bank otherwise recovers less than $200. In *Example 11*, C additionally agrees to indemnify A for up to $100 that A pays with respect to A's guarantee. The comment explained that, in *Example 10*, $300 of the liability is recognized and allocated (to A), but in *Example 11*, only $100 is recognized and allocated (in the amount indemnified by C). The full $300 payment obligation would have been recognized and allocated if made by one partner, but splitting it across two partners caused $200 of the collective payment obligation to be ignored. This result is notwithstanding that $300 of the same first-dollars of the $1,000 partnership liability in the example was guaranteed by the partners.

Although recommending revocation of the 752 Temporary Regulations, this commenter recognized that prior regulations under section 752 allow partners that have no practical economic risk to be allocated debt. As a compromise, this commenter proposed that if the Treasury Department and the IRS are concerned with bottom dollar payment obligations that lack economic reality, the temporary regulations should be replaced with a rule that does not recognize obligations below a certain threshold. The commenter recommended, as an example, that obligations limited to the bottom one-third of a debt obligation not be recognized, but once the obligation is above that threshold, the entire obligation is recognized. The commenter argued that such a rule would provide greater certainty than the 752 Temporary Regulations and recognize that the guarantor has risk.

The 752 Temporary Regulations and these final regulations implement Congressional intent. Bottom dollar payment obligations do not represent real EROL because those payment obligations are structured to insulate the obligor from having to pay their obligations.

Moreover, bottom dollar guarantees are not relevant to loan risk underwriting generally. These obligations generally lack a significant non-tax commercial business purpose. Therefore, bottom dollar payment obligations should not be recognized as payment obligations. Despite the commenter's assertion that there could be some risk to partners with bottom dollar payment obligations, the Treasury Department and the IRS received no comments (including from this commenter) on the 752 Temporary Regulations or the 752 Proposed Regulations demonstrating that bottom dollar payment obligations have a significant non-tax commercial business purpose. Nor did any commenter propose an alternative that resolves the concerns raised in the preamble to the 752 Temporary Regulations that, under the prior section 752 regulations, partners and related persons entered into payment obligations that were not commercial solely to achieve an allocation of a partnership liability. The compromise proposal offered by this commenter would significantly lower the threshold for the amount required to be economically at risk from 90 percent of a partner's or related person's initial payment obligation to 33 percent without explaining why the lower threshold is more appropriate. Indeed, the compromise could still allow a partner with no practical economic risk to be allocated debt. These final regulations comport with Congress' directive in response to *Raphan*. Moreover, *Examples 10* and *11* in §1.752-2(f) are not inconsistent with one another, but show how an otherwise recognized payment obligation can become a bottom dollar payment obligation when the initial payment obligor no longer bears the real EROL as a result of a subsequent indemnity. For these reasons, the Treasury Department and the IRS do not adopt the commenter's suggestions.

The 752 Temporary Regulations further require taxpayers to disclose bottom dollar payment obligations by filing Form 8275, Disclosure Statement, or any successor form, with the return of the partnership for the taxable year in which a bottom dollar payment obligation is undertaken or modified. These final regulations clarify that identifying the payment obligation with respect to which disclosure is made includes stating whether the obligation is a guarantee, a reimbursement, an indemnity, or deficit restoration obligation.

B. *Capital contribution and deficit restoration obligations*

Generally, the regulations under section 752 provide a description of obligations recognized as payment obligations under §1.752-2(b)(1). The 752 Temporary Regulations further provide that all statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying §1.752-2, including obligations to the partnership that are imposed by the partnership agreement, such as the obligation to make a capital contribution and a deficit restoration obligation. See §1.752-2T(b)(3).

A commenter expressed concerns that, although it is clear that a capital contribution obligation and a deficit restoration obligation are types of payment obligations to which §1.752-2 applies, the definition of a bottom dollar payment obligation provides no guidance as to how to determine whether a capital contribution obligation or a deficit restoration obligation is a bottom dollar payment obligation. For example, a deficit restoration obligation does not relate to a particular partnership liability and the proceeds of the deficit restoration obligation may be paid to creditors of the partnership or distributed to other partners. See §1.704-1(b)(2)(ii)(*b*)(*3*). These final regulations thus revise the definition of a bottom dollar payment obligation to specifically address capital contribution obligations and deficit restoration obligations. Section 1.752-2(b)(3)(ii)(C)(*1*)(*iii*) in these final regulations provides that a bottom dollar payment obligation includes, with respect to a capital contribution obligation and a deficit restoration obligation, any payment obligation other than one in which the partner is or would be required to make the full amount of the partner's capital contribution or to restore the full amount of the partner's deficit capital account.

C. *Anti-abuse rule in §1.752-2(j)(2)*

The 752 Temporary Regulations provide that irrespective of the form of the contractual obligation, the Commissioner may treat a partner as bearing the EROL with respect to a partnership liability, or portion thereof, to the extent that: (1) the partner or related person undertakes one or more contractual obligations so that the partnership may obtain or retain a loan; (2) the contractual obligations of the partner or related person significantly reduce the risk to the lender that the partnership will not satisfy its obligations under the loan, or portion thereof; and (3) with respect to the contractual obligations described in (1) or (2), (i) one of the principal purposes of using the contractual obligation is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests, or (ii) another partner, or person related to another partner, enters into a payment obligation and a principal purpose of the arrangement is to cause the payment obligation to be disregarded. See §1.752-2T(j)(2).

A commenter argued that because this anti-abuse rule is at the Commissioner's discretion, taxpayers are uncertain how to treat certain liabilities that would otherwise be bottom dollar payment obligations. One of the purposes of the 752 Temporary Regulations is to ensure that only genuine commercial payment obligations, including guarantees and indemnities, affect the allocation of partnership liabilities. Indeed, commenters to the 2014 Proposed Regulations noted that partners can manipulate contractual arrangements to achieve a federal income tax result that is not consistent with the economics of an arrangement. This is true both of a payment obligation that does not represent a real EROL as well as an agreement that purposefully creates the appearance of a bottom dollar payment obligation even if that taxpayer (or a person related to that taxpayer) bears the EROL. The anti-abuse rule, therefore, is appropriate. However, in response to comments regarding uncertainty caused because the anti-abuse rule in the 752 Temporary Regulations applied at the Commissioner's discretion, the final regulations remove the discretionary language consistent with the rule in the regulations under section 752 prior to the 752 Temporary Regulations.

D. *Applicability date and transitional rule*

The 752 Temporary Regulations for bottom dollar payment obligations generally apply to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken with respect to a partnership liability on or after October 5, 2016, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date. Under the 752 Temporary Regulations, a transitional rule applies to any partner whose allocable share of partnership liabilities under §1.752-2 exceeded its adjusted basis in its partnership interest as determined under §1.705-1 on October 5, 2016 (Grandfathered Amount). To the extent of that excess, those partners may continue to apply the prior regulations under §1.752-2 with respect to a partnership liability for a seven-year period. The amount of partnership liabilities subject to transition relief decreases for certain reductions in the amount of liabilities allocated to that partner under the transitional rule and, upon the sale of any partnership property, for any tax gain (including section 704(c) gain) allocated to the partner less that partner's share of amount realized.

A commenter explained that the rule in §1.704-2(g)(3) regarding conversions of recourse or partner nonrecourse liabilities into nonrecourse liabilities may overlap and potentially conflict with the transitional rule. This commenter noted that the transitional rule may be unnecessary, but, regardless, believes that the transitional rule should be coordinated with §1.704-2(g)(3).

Section 1.704-2(g)(3) provides that a partner's share of partnership minimum gain is increased to the extent provided in §1.704-2(g)(3) if a recourse or partner nonrecourse liability becomes partially or wholly nonrecourse. If a recourse liability becomes a nonrecourse liability, a partner has a share of the partnership's minimum gain that results from the conversion equal to the partner's deficit capital account (determined under §1.704-1(b)(2)(iv)) to the extent the partner no longer bears the economic burden for the entire deficit capital account as a result of the conversion. The determination of the extent to which a partner bears the economic burden for a deficit capital account is made by determining the consequences to the partner in the case of a complete liquidation of the partnership immediately after the conversion applying the rules described in §1.704-1(b)(2)(iii)(*c*) that deem the value of partnership property to equal its basis, taking into account section 7701(g) in the case of property that secures nonrecourse indebtedness. If a partner nonrecourse debt becomes a nonrecourse liability, the partner's share of partnership minimum gain is increased to the extent the partner is not subject to the minimum gain chargeback requirement under §1.704-2(i)(4). The commenter asserts that §1.704-2(g)(3) increases a partner's share of minimum gain which increases the partner's capital account to reflect the same result as if nonrecourse deductions had been taken all along. The gain, if it would have been triggered as a result of a partner's negative section 704(b) account with no deficit reduction obligation, is deferred because under §1.704-2(g)(3), the partner's share of minimum gain increases. The commenter argues that §1.752-3(a)(1) or (2) would apply to allocate the nonrecourse liability to the partner and, therefore, the partner would still be allocated a share of the partnership liability eliminating the need for the transitional rule.

Notwithstanding the rule in §1.704-2(g)(3), the transitional rule is necessary to address certain situations when §1.704-2(g)(3) would not apply because, for example, before these regulations were finalized, a bottom dollar deficit restoration obligation is regarded for section 704 purposes, but is disregarded for section 752 purposes. In that case, a partner could recognize gain under section 731 without the transitional rule. Additionally, because §1.752-3(a)(1) and (2) do not apply in determining a partner's share of a partnership nonrecourse liability for disguised sale purposes, a disguised sale could occur if a partner's share of liabilities under §1.752-3(a)(3) does not cover the Grandfathered Amount.

To the extent that the transitional rule applies to a partner's share of a recourse partnership liability as a result of the partner bearing the EROL under §1.752-2(b), the partner's share of the liability can continue to be determined under §1.752-2 and is not converted into a nonrecourse liability under §1.752-3. In this situation, because a recourse or partner nonrecourse liability does not become partially or wholly nonrecourse as a result of the transitional rule, the rule in §1.704-2(g)(3) would not apply until the expiration of the seven-year period. If a partner does not want to apply the transitional rule in determining its share of a partnership liability because it believes that the rule in §1.704-2(g)(3) effectively defers any negative tax consequences that could occur when a recourse or partner nonrecourse liability becomes partially or wholly nonrecourse, the partner must then apply the rules under §1.752-2, as amended after October 5, 2016, in determining its share of a partnership liability.

This commenter also noted that the transitional rule should clarify whether it applies to refinanced liabilities. The bottom dollar payment obligation rules do not apply to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect before October 5, 2016. The preamble to the 752 Temporary Regulations explains that commenters on the 2014 Proposed Regulations had recommended that partnership liabilities or payment obligations that are modified or refinanced continue to be subject to the provisions of the previous regulations to the extent of the amount and duration of the pre-modification (or refinancing) liability or payment obligation. The preamble explains that the 752 Temporary Regulations do not adopt this recommendation as the terms of the partnership liabilities and payment obligations could be changed, which would affect the determination of whether or not an obligation is a bottom dollar payment obligation, but instead provided transition relief. Under the transitional rule, if a debt entered into before October 5, 2016, is not refinanced, these final regulations do not apply. If the debt is refinanced, then these regulations apply, but the partner could instead choose to apply the transitional rule to the extent of the Grandfathered Amount. Although the transitional rule in the 752 Temporary Regulations applies to modified or refinanced obligations, these final regulations further clarify that the transitional rule applies to modified and refinanced liabilities.

2. *Additional Guidance on Disregarding Purported Payment Obligations*

A. *Deficit restoration obligation factors*

The 752 Proposed Regulations add a list of factors to §1.704-1(b)(2)(ii)(*c*) that are similar to the factors in the proposed anti-abuse rule under §1.752-2(j) (discussed in Section 2.B. of the Summary of Comments and Explanations of Revisions in this preamble), but specific to deficit restoration obligations, to indicate when a plan to circumvent or avoid an obligation exists. If a plan to circumvent or avoid an obligation exists, the obligation is disregarded for purposes of sections 704 and 752. Under proposed §1.704-1(b)(2)(ii)(*c*), the following factors indicate a plan to circumvent or avoid an obligation: (1) the partner is not subject to commercially reasonable provisions for enforcement and collection of the obligation; (2) the partner is not required to provide (either at the time the obligation is made or periodically) commercially reasonable documentation regarding the partner's financial condition to the partnership; (3) the obligation ends or could, by its terms, be terminated before the liquidation of the partner's interest in the partnership or when the partner's capital account as provided in §1.704-1(b)(2)(iv) is negative; and (4) the terms of the obligation are not provided to all the partners in the partnership in a timely manner.

The Treasury Department and the IRS are aware that a partner's transfer of its deficit restoration obligation to a transferee who agrees to the same deficit restoration obligation could run afoul of the third factor and cause the partner's deficit restoration obligation to be disregarded. However, under these final regulations, the weight to be given to any particular factor depends on the particular facts and the presence or absence of any particular factor is not, in itself, necessarily indicative of whether or not the obligation is respected. The fact that a transferee agrees to the same deficit restoration obligation should be taken into account when determining whether a plan to circumvent or avoid an obligation exists. In addition, these final regulations add an exception to this factor when a transferee partner assumes the obligation.

B. *Anti-abuse factors under §1.752-2(j)(3)*

The 2014 Proposed Regulations included a list of factors to determine whether a partner's or related person's obligation to make a payment with respect to a partnership liability (excluding those imposed by state law) would be recognized for purposes of section 752. In response to comments, the 752 Proposed Regulations moved the list of factors to an anti-abuse rule in §1.752-2(j)(3), other than the recognition factors concerning bottom dollar guarantees and indemnities, which are addressed in the 752 Temporary Regulations. Under the anti-abuse rule in the 752 Proposed Regulations, the following non-exclusive factors are weighed to determine whether a payment obligation should be respected: (1) the partner or related person is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, (2) the partner or related person is not required to provide commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party, (3) the term of the payment obligation ends prior to the term of the partnership liability, or the partner or related person has a right to terminate its payment obligation, (4) there exists a plan or arrangement in which the primary obligor or any other obligor with respect to the partnership liability directly or indirectly holds money or other liquid assets in an amount that exceeds the reasonable foreseeable needs of such obligor, (5) the payment obligation does not permit the creditor to promptly pursue payment following a payment default on the partnership liability, or other arrangements with respect to the partnership liability or payment obligation otherwise indicate a plan to delay collection, (6) in the case of a guarantee or similar arrangement, the terms of the partnership liability would be substantially the same had the partner or related person not agreed to provide the guarantee, and (7) the creditor or other party benefiting from the obligation did not receive executed documentation with respect to the payment obligation from the partner or related person before, or within a commercially reasonable period of time after, the creation of the obligation. The weight to be given to any particular factor depends on the particular case and the presence or absence of any particular factor, in itself, is not necessarily indicative of whether or not a payment obligation is recognized under §1.752-2(b).

A commenter expressed concerns with the listed factors asserting that they are drafted to make an obligation fail (that the debt will be nonrecourse) because an obligation is unlikely to satisfy all seven factors. The commenter also argued that the factors are subject to manipulation by taxpayers who desire nonrecourse debt treatment. Finally, the commenter was concerned with the subjective and speculative inquiry regarding the fourth and sixth factors.

The seven factors are appropriate considerations in determining whether a plan to circumvent or avoid an obligation exists. The 2014 Proposed Regulations provided that a payment obligation with respect to a partnership liability was not recognized under §1.752-2(b)(3) unless all of the factors were met. At commenters' requests and due to concerns that the rule was too strict, the 752 Proposed Regulations moved the list of factors from the operative rule to the anti-abuse rule where they are now just factors to examine in determining whether a plan to circumvent or avoid an obligation exists. In response to the comment on the 752 Proposed Regulations, however, these final regulations add clarification to the fourth factor that amounts are not held in excess of the reasonably foreseeable needs of an obligor if the partnership purchases standard commercial insurance, such as casualty insurance. Additionally, these final regulations list certain types of commercially reasonable documentation (balance sheets and financial statements) as examples of documents a lender would typically require.

A commenter also requested that the final regulations clarify how the assumption rule in §1.752-1(d) relates to the factors in §1.752-2(j). Under §1.752-1(b), any increase in a partner's share of partnership liabilities, or any increase in a partner's individual liabilities by reason of the partner's assumption of partnership liabilities, is treated as a contribution of money by that partner to the partnership. Conversely, §1.752-1(c) provides that any decrease in a partner's share of partnership liabilities, or any decrease in a partner's individual liabilities by reason of the partnership's assumption of the individual liabilities of the partner, is treated as a distribution of money by the partnership to that partner. The assumption rule in §1.752-1(d) applies to determine whether a partner has assumed a partnership liability (treated as a contribution under section 752(a)), or the partnership has assumed a partner liability (treated as a distribution under section 752(b)). Generally under §1.752-1(d), a person is considered to assume a liability only to the extent that (1) the assuming person is personally obligated to pay the liability; and (2) if a partner or related person assumes a partnership liability, the person to whom the liability is owed knows of the assumption and can directly enforce the partner's or related person's obligation for the liability, and no other partner or person that is a related person to another partner would bear the EROL for the liability immediately after the assumption. Sections 1.752-2 and 1.752-3 provide the rules for determining a partner's share of partnership recourse and nonrecourse liabilities.

The analysis for determining whether a partner or person that is a related person to a partner bears the EROL for a liability for purposes of the assumption rule in §1.752-1(d) should be the same analysis for determining whether a partner or related person bears the EROL under §1.752-2, including the factors in §1.752-2(j) for payment obligations. Therefore, these final regulations add a cross reference in §1.752-1(d) to clarify that an assumption will be treated as giving rise to a payment obligation only to the extent no other partner or a person related to another partner bears the EROL for the liability as determined under §1.752-2.

C. *Reasonable expectation of ability to satisfy obligation*

The satisfaction presumption in §1.752-2(b)(6) of the existing regulations is subject to a disregarded entity net value requirement under existing §1.752-2(k). The 2014 Proposed Regulations expanded the scope of the net value requirement and provided that, in determining the extent to which a partner or related person other than an individual or a decedent's estate bears the EROL for a partnership liability other than a trade payable, a payment obligation is recognized only to the extent of the net value of the partner or related person that, as of the allocation date, is allocated to the liability, as determined under §1.752-2(k). The 2014 Proposed Regulations also required a partner to provide a statement concerning the net value of a person with a payment obligation (a payment obligor) to the partnership. The preamble to the 2014 Proposed Regulations requested comments concerning whether the net value rule should also apply to individuals and estates and whether the regulations should consolidate these rules under §1.752-2(k).

Comments on the 2014 Proposed Regulations suggested that if the net value rule is retained, §1.752-2(k) should be extended to all partners and related persons other than individuals. A commenter expressed concerns that a partner who may be treated as bearing the EROL with respect to a partnership liability would have to provide information regarding the net value of a payment obligor, which is unnecessarily intrusive. Another commenter believed that if the rules requiring net value were extended to all partners in partnerships, the attempt to achieve more realistic substance would be accompanied by a corresponding increase in the potential for manipulation.

The preamble to the 752 Proposed Regulations explains that the Treasury Department and the IRS remain concerned with ensuring that a partner or related person be presumed to satisfy its payment obligation only to the extent that such partner or related person would be able to pay the obligation. After consideration of the comments to the 2014 Proposed Regulations, however, the Treasury Department and the IRS agreed that expanding the application of the net value rules under §1.752-2(k) may lead to more litigation and may unduly burden taxpayers. Furthermore, net value as provided in §1.752-2(k) may not accurately take into account future earnings of a business entity, which normally factor into lending decisions. Therefore, the 752 Proposed Regulations proposed to remove §1.752-2(k) of the existing regulations and instead create a new presumption under the anti-abuse rule in §1.752-2(j).

Under the presumption in the 752 Proposed Regulations, evidence of a plan to circumvent or avoid an obligation is deemed to exist if the facts and circumstances indicate that there is not a reasonable expectation that the payment obligor will have the ability to make the required payments if the payment obligation becomes due and payable (Presumed Anti-abuse Rule). A payment obligor includes disregarded entities (including grantor trusts). If evidence of a plan to circumvent or avoid the obligation exists or is deemed to exist, the obligation is not recognized under §1.752-2(b) and therefore the partnership liability is treated as a nonrecourse liability under §1.752-1(a)(2).

Commenters argued that §1.752-2(k) should be retained, however, because it provides clarity and certainty to taxpayers. One commenter suggested that if the government believes that the Presumed Anti-abuse Rule is necessary, §1.752-2(k) should still be retained, or, alternatively, expanded to all partners and related persons other than individuals. This commenter noted that the Presumed Anti-abuse Rule creates uncertainty as it is not clear that taxpayers may proactively assert the Presumed Anti-abuse Rule. The commenter suggested that the final regulations clarify that motive and intent are irrelevant in determining whether the Presumed Anti-abuse Rule applies and that no actual plan to circumvent or avoid an obligation needs to exist.

Expanding the application of §1.752-2(k) in the existing regulations would unduly burden taxpayers and would not accurately reflect economics. A more accurate reflection of economics is to determine whether a debtor will have the ability to make payments when due, not necessarily to whether the debtor has sufficient assets to satisfy an obligation currently. The Treasury Department and the IRS agree with the commenter, however, that the Presumed Anti-abuse Rule could create confusion and uncertainty. These final regulations, therefore, amend §1.752-2(k) and clarify how the satisfaction presumption in §1.752-2(b)(6) relates to §1.752-2(k) in these final regulations. Amended §1.752-2(k) applies to all partners of a partnership, including partners that are disregarded entities or grantor trusts.

Under these final regulations, it is assumed that all payment obligors actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate that at the time the partnership determines a partner's share of partnership liabilities under §§1.705-1(a) and 1.752-4(d) there is not a commercially reasonable expectation that the payment obligor will have the ability to make the required payments under the terms of the obligation if the obligation becomes due and payable. A partner or related person's ability to pay may be based on documents such as, but not limited to, balance sheets, income statements, cash flow statements, credit reports, and projected future financial results.

D. *General applicability date*

Except as provided in Section 1.D. of the Summary of Comments and Explanations of Revisions in this preamble relating to bottom dollar payments obligations, these final regulations apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after October 9, 2019, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date.

3. *Additional Issues Concerning Partnership Liabilities That Are Outside the Scope of These Regulations*

A commenter recommended guidance in determining a partner's amount at risk under section 465 for deficit restoration obligations. This commenter noted that under *Hubert Enterprises, Inc. v. Commissioner*, T.C. Memo. 2008-46, a deficit restoration obligation was not treated as giving a partner at risk basis because the obligation was contingent (because it was dependent upon the partner liquidating his interest) and the amount was uncertain (the deficit restoration obligation covered only the deficit in the partner's capital account at the time of liquidation and did not cover the entire debt obligation at issue). The commenter also recommended providing guidance under section 465 similar to that provided in these final regulations regarding when guarantees will be recognized. Providing guidance concerning section 465 is beyond the scope of these regulations. The Treasury Department and the IRS request comments, however, concerning whether guidance is needed to address issues under section 465.

The commenter recommended that these regulations incorporate standards to determine when a debt is recourse to a partnership under section 1001. The commenter questioned whether that test under section 1001 is performed at the partnership or partner level. These final regulations provide guidance as to how liabilities are allocated to partners in a partnership and do not concern how liabilities are characterized to the partnership under section 1001. This comment is thus outside the scope of these regulations.

This commenter also suggested that the Treasury Department and the IRS consider whether the rules in section 357(d) should have been adopted for partnerships since section 357(d)(3) states that the Secretary may also prescribe regulations which provide that the manner in which a liability is treated as assumed under section 357(d) is applied, where appropriate, elsewhere in Title 26. Section 357(d)(1)(A) provides that a recourse liability (or portion thereof) shall be treated as having been assumed if, as determined on the basis of all facts and circumstances, the transferee has agreed to, and is expected to, satisfy such liability (or portion), whether or not the transferor has been relieved of such liability. Section 357(d)(1)(B) provides that except as provided in section 357(d)(2), a nonrecourse liability shall be treated as having been assumed by the transferee of any asset subject to such liability. This recommended change is beyond the scope of these regulations, which are concerned with whether a partnership debt is recourse or non-recourse to a partner in the partnership.

The 752 Proposed Regulations requested comments concerning exculpatory liabilities in response to comments received on the 2014 Proposed Regulations requesting guidance with respect to such liabilities. An exculpatory liability is a liability that is recourse to an entity under state law and section 1001, but no partner bears the EROL within the meaning of section 752. Thus, the liability is treated as nonrecourse for section 752 purposes. The Treasury Department and the IRS, after acknowledging that exculpatory liabilities are beyond the scope of the 752 Proposed Regulations, sought additional comments regarding the proper treatment of an exculpatory liability under regulations under section 704(b) and the effect of such a liability's classification under section 1001. Further, the Treasury Department and the IRS requested additional comments addressing the allocation of an exculpatory liability among multiple assets and possible methods for calculating minimum gain with respect to such liability, such as the so-called "floating lien" approach (whereby all the assets in the entity, including cash, are considered to be subject to the exculpatory liability) or a specific allocation approach. The Treasury Department and the IRS continue to consider the comments received concerning exculpatory liabilities under sections 704 and 752.

Special Analyses

These final regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to report the required information will be minimal in that it requires partnerships (including partnerships that may be small entities) to provide information they already maintain or can easily obtain to the IRS. Moreover, it should take a partnership no more than 2 hours to satisfy the information requirement in these regulations. Accordingly, this rule will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Paperwork Reduction Act

The collection of information contained in these final regulations under section 752 is reported on Form 8275, Disclosure Statement, and has been reviewed in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) and approved by the Office of Management and Budget under control number 1545-0889.

The collection of information in these final regulations under section 752 is in §1.752-2(b)(3)(ii)(D). This information is required by the IRS to ensure that section 752 of the Code and applicable regulations are properly applied for allocations of partnership liabilities. The respondents will be partners and partnerships.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

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

Drafting Information

The principal author of these regulations is Caroline E. Hay, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.704-1 is amended by:

1. Adding two sentences to the end of paragraph (b)(1)(ii)(*a*).
2. Adding a sentence to the end of paragraph (b)(2)(ii)(*b*)(*3*) introductory text.
3. Removing the undesignated paragraph following paragraph (b)(2)(ii)(*b*)(*3*).
4. Adding paragraphs (b)(2)(ii)(*b*)(*4*) through (*7*).
5. Revising paragraph (b)(2)(ii)(*c*).

The additions and revisions read as follows:

§1.704-1 Partner's distributive share.

* * * * *

(b) * * *

(1) * * *

(ii) * * *

(*a*) * * * Furthermore, the last sentence of paragraph (b)(2)(ii)(*b*)(*3*) of this section and paragraphs (b)(2)(ii)(*b*)(*4*) through (*7*) and (b)(2)(ii)(*c*) of this section apply to partnership taxable years ending on or after October 9, 2019. However, taxpayers may apply the last sentence of paragraph (b)(2)(ii)(*b*)(*3*) of this section and paragraphs (b)(2)(ii)(*b*)(*4*) through (*7*) and (b)(2)(ii)(*c*) of this section for partnership taxable years ending on or after October 5, 2016. For partnership taxable years ending before October 9, 2019, see §1.704-1 as contained in 26 CFR part 1 revised as of April 1, 2019.

* * * * *

(2) * * *

(ii) * * *

(*b*) * * *

(*3*) * * * Notwithstanding the partnership agreement, an obligation to restore a deficit balance in a partner's capital account, including an obligation described in paragraph (b)(2)(ii)(*c*)(*1*) of this section, will not be respected for purposes of this section to the extent the obligation is disregarded under paragraph (b)(2)(ii)(*c*)(*4*) of this section.

(*4*) For purposes of paragraphs (b)(2)(ii)(*b*)(*1*) through (*3*) of this section, a partnership taxable year shall be determined without regard to section 706(c)(2)(A).

(*5*) The requirements in paragraphs (b)(2)(ii)(*b*)(*2*) and (*3*) of this section are not violated if all or part of the partnership interest of one or more partners is purchased (other than in connection with the liquidation of the partnership) by the partnership or by one or more partners (or one or more persons related, within the meaning of section 267(b) (without modification by section 267(e)(1)) or section 707(b)(1), to a partner) pursuant to an agreement negotiated at arm's length by persons who at the time such agreement is entered into have materially adverse interests and if a principal purpose of such purchase and sale is not to avoid the principles of the second sentence of paragraph (b)(2)(ii)(*a*) of this section.

(*6*) The requirement in paragraph (b)(2)(ii)(*b*)(*2*) of this section is not violated if, upon the liquidation of the partnership, the capital accounts of the partners are increased or decreased pursuant to paragraph (b)(2)(iv)(*f*) of this section as of the date of such liquidation and the partnership makes liquidating distributions within the time set out in the requirement in paragraph (b)(2)(ii)(*b*)(*2*) of this section in the ratios of the partners' positive capital accounts, except that it does not distribute reserves reasonably required to provide for liabilities (contingent or otherwise) of the partnership and installment obligations owed to the partnership, so long as such withheld amounts are distributed as soon as practicable and in the ratios of the partners' positive capital account balances.

(*7*) See *Examples 1.(i)* and *(ii)*, *4.(i)*, *8.(i)*, and *16.(i)* of paragraph (b)(5) of this section for issues concerning paragraph (b)(2)(ii)(*b*) of this section.

(*c*) *Obligation to restore deficit*—(*1*) *Other arrangements treated as obligations to restore deficits*. If a partner is not expressly obligated to restore the deficit balance in such partner's capital account, such partner nevertheless will be treated as obligated to restore the deficit balance in his capital account (in accordance with the requirement in paragraph (b)(2)(ii)(*b*)(*3*) of this section and subject to paragraph (b)(2)(ii)(*c*)(*2*) of this section) to the extent of—

(*A*) The outstanding principal balance of any promissory note (of which such partner is the maker) contributed to the partnership by such partner (other than a promissory note that is readily tradable on an established securities market), and

(*B*) The amount of any unconditional obligation of such partner (whether imposed by the partnership agreement or by state or local law) to make subsequent contributions to the partnership (other than pursuant to a promissory note of which such partner is the maker).

(*2*) *Satisfaction requirement*. For purposes of paragraph (b)(2)(ii)(*c*)(*1*) of this section, a promissory note or unconditional obligation is taken into account only if it is required to be satisfied at a time no later than the end of the partnership taxable year in which such partner's interest is liquidated (or, if later, within 90 days after the date of such liquidation). If a promissory note referred to in paragraph (b)(2)(ii)(*c*)(*1*) of this section is negotiable, a partner will be considered required to satisfy such note within the time period specified in this paragraph (b)(2)(ii)(*c*)(*2*) if the partnership agreement provides that, in lieu of actual satisfaction, the partnership will retain such note and such partner will contribute to the partnership the excess, if any, of the outstanding principal balance of such note over its fair market value at the time of liquidation. See paragraph (b)(2)(iv)(*d*)(*2*) of this section. See *Examples 1.(ix)* and *(x)* of paragraph (b)(5) of this section.

(*3*) *Related party notes*. For purposes of paragraph (b)(2) of this section, if a partner contributes a promissory note to the partnership during a partnership taxable year beginning after December 29, 1988, and the maker of such note is a person related to such partner (within the meaning of §1.752-4(b)(1)), then such promissory note shall be treated as a promissory note of which such partner is the maker.

(*4*) *Obligations disregarded*—(*A*) *General rule*. A partner in no event will be considered obligated to restore the deficit balance in his capital account to the partnership (in accordance with the requirement in paragraph (b)(2)(ii)(*b*)(*3*) of this section) to the extent such partner's obligation is a bottom dollar payment obligation that is not recognized under §1.752-2(b)(3) or is not legally enforceable, or the facts and circumstances otherwise indicate a plan to circumvent or avoid such obligation. See paragraphs (b)(2)(ii)(*f*), (b)(2)(ii)(*h*), and (b)(4)(vi) of this section for other rules regarding such obligation. To the extent a partner is not considered obligated to restore the deficit balance in the partner's capital account to the partnership (in accordance with the requirement in paragraph (b)(2)(ii)(*b*)(*3*) of this section), the obligation is disregarded and paragraph (b)(2) of this section and §1.752-2 are applied as if the obligation did not exist.

(*B*) *Factors indicating plan to circumvent or avoid obligation*. In the case of an obligation to restore a deficit balance in a partner's capital account upon liquidation of a partnership, paragraphs (b)(2)(ii)(*c*)(*4*)(*B*)(*i*) through (*iv*) of this section provide a non-exclusive list of factors that may indicate a plan to circumvent or avoid the obligation. For purposes of making determinations under this paragraph (b)(2)(ii)(*c*)(*4*), the weight to be given to any particular factor depends on the particular case and the presence or absence of any particular factor is not, in itself, necessarily indicative of whether or not the obligation is respected. The following factors are taken into consideration for purposes of this paragraph (b)(2):

(*i*) The partner is not subject to commercially reasonable provisions for enforcement and collection of the obligation.

(*ii*) The partner is not required to provide (either at the time the obligation is made or periodically) commercially reasonable documentation regarding the partner's financial condition to the partnership.

(*iii*) The obligation ends or could, by its terms, be terminated before the liquidation of the partner's interest in the partnership or when the partner's capital account as provided in §1.704-1(b)(2)(iv) is negative other than when a transferee partner assumes the obligation.

(*iv*) The terms of the obligation are not provided to all the partners in the partnership in a timely manner.

* * * * *

Par. 3. Section 1.752-0 is amended by:

1. Adding entries for §1.752-1(d)(1) and (2).
2. Adding entries for §1.752-2(b)(3)(i) and (ii), (b)(3)(ii)(A) through (C), (b)(3)(ii)(C)(*1*) through (*3*), (b)(3)(ii)(D), and (b)(3)(iii).
3. Adding entries for §1.752-2(j)(2)(i) and (ii).
4. Adding entries for §1.752-2(j)(3)(i) through (ii).
5. Revising the entries for §1.752-2(j)(3) and (4).
6. Adding entries for §1.752-2(k) and (k)(1) and (2).
7. Adding an entry for §1.752-2(l).

The additions and revisions read as follows:

§1.752-0 Table of contents.

* * * * *

§1.752-1 Treatment of partnership liabilities.

* * * * *

(d) * * *

(1) In general.

(2) Applicability date.

* * * * *

§1.752-2 Partner's share of recourse liabilities.

* * * * *

(b) * * *

(3) * * *

(i) In general.

(ii) Special rules for bottom dollar payment obligations.

(A) In general.

(B) Exception.

(C) Definition of bottom dollar payment obligation.

(*1*) In general.

(*2*) Exceptions.

(*3*) Benefited party defined.

(D) Disclosure of bottom dollar payment obligations.

(iii) Special rule for indemnities and reimbursement agreements.

* * * * *

(j) * * *

(2) * * *

(i) In general.

(ii) Economic risk of loss.

(3) Plan to circumvent or avoid an obligation.

(i) General rule.

(ii) Factors indicating plan to circumvent or avoid an obligation.

(4) Example.

(k) No reasonable expectation of payment.

(1) In general.

(2) Examples.

(l) Applicability dates.

* * * * *

Par. 4. Section 1.752-1 is amended by:

1. Redesignating paragraphs (d)(1) and (2) as paragraphs (d)(1)(i) and (ii), respectively, and revising newly redesignated paragraph (d)(1)(ii).

2. Redesignating the text of paragraph (d) introductory text following its subject heading as paragraph (d)(1), revising the heading for paragraph (d), and adding a heading to newly redesignated paragraph (d)(1).
3. Adding paragraph (d)(2).

The revisions and additions read as follows:

§1.752-1 Treatment of partnership liabilities.

* * * * *

(d) * * *

(1) *In general*. * * *

(ii) If a partner or related person assumes a partnership liability, the person to whom the liability is owed knows of the assumption and can directly enforce the partner's or related person's obligation for the liability, and no other partner or person that is a related person to another partner would bear the economic risk of loss for the liability under §1.752-2 immediately after the assumption.

(2) *Applicability date*. Paragraph (d)(1)(ii) of this section applies to liabilities incurred or assumed by a partnership on or after October 9, 2019**.** The rules applicable to liabilities incurred or assumed prior to October 9, 2019, are contained in §1.752-1 in effect prior to October 9, 2019, (see 26 CFR part 1 revised as of April 1, 2019).

* * * * *

Par. 5. Section 1.752-2 is amended by:

1. Revising paragraphs (b)(3) and (6).
2. Adding a sentence to the end of paragraph (f) introductory text.
3. Designating *Example 1* through *11* of paragraph (f) as paragraph (f)(1) through (f)(11), respectively.
4. Removing and reserving newly redesignated paragraph (f)(9).
5. Revising newly redesignated paragraphs (f)(10) and (11).
6. Revising paragraphs (j)(2) and (3).
7. Adding paragraph (j)(4).
8. Revising paragraphs (k) and (l).

The revisions and additions read as follows:

§1.752-2 Partner's share of recourse liabilities.

* * * * *

(b) * * *

(3) *Obligations recognized*—(i) *In general*. The determination of the extent to which a partner or related person has an obligation to make a payment under §1.752-2(b)(1) is based on the facts and circumstances at the time of the determination. To the extent that the obligation of a partner or related person to make a payment with respect to a partnership liability is not recognized under this paragraph (b)(3), §1.752-2(b) is applied as if the obligation did not exist. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying this section, including—

(A) Contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors, to other partners, or to the partnership;

(B) Obligations to the partnership that are imposed by the partnership agreement, including the obligation to make a capital contribution and to restore a deficit capital account upon liquidation of the partnership as described in §1.704-1(b)(2)(ii)(*b*)(*3*) (taking into account §1.704-1(b)(2)(ii)(*c*)); and

(C) Payment obligations (whether in the form of direct remittances to another partner or a contribution to the partnership) imposed by state or local law, including the governing state or local law partnership statute.

(ii) *Special rules for bottom dollar payment obligations*—(A) *In general*. For purposes of §1.752-2, a bottom dollar payment obligation (as defined in paragraph (b)(3)(ii)(C) of this section) is not recognized under this paragraph (b)(3).

(B) *Exception*. If a partner or related person has a payment obligation that would be recognized under this paragraph (b)(3) (initial payment obligation) but for the effect of an indemnity, a reimbursement agreement, or a similar arrangement, such bottom dollar payment obligation is recognized under this paragraph (b)(3) if, taking into account the indemnity, reimbursement agreement, or similar arrangement, the partner or related person is liable for at least 90 percent of the partner's or related person's initial payment obligation.

(C) *Definition of bottom dollar payment obligation*—(*1*) *In general*. Except as provided in paragraph (b)(3)(ii)(C)(*2*) of this section, a *bottom dollar payment obligation* is a payment obligation that is the same as or similar to a payment obligation or arrangement described in this paragraph (b)(3)(ii)(C)(*1*).

(*i*) With respect to a guarantee or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation if, and to the extent that, any amount of the partnership liability is not otherwise satisfied.

(*ii*) With respect to an indemnity or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation, if, and to the extent that, any amount of the indemnitee's or benefited party's payment obligation that is recognized under this paragraph (b)(3) is satisfied.

(*iii*) With respect to an obligation to make a capital contribution or to restore a deficit capital account upon liquidation of the partnership as described in §1.704-1(b)(2)(ii)(*b*)(*3*) (taking into account §1.704-1(b)(2)(ii)(*c*)), any payment obligation other than one in which the partner is or would be required to make the full amount of the partner's capital contribution or to restore the full amount of the partner's deficit capital account.

(*iv*) An arrangement with respect to a partnership liability that uses tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements to convert what would otherwise be a single liability into multiple liabilities if, based on the facts and circumstances, the liabilities were incurred pursuant to a common plan, as part of a single transaction or arrangement, or as part of a series of related transactions or arrangements, and with a principal purpose of avoiding having at least one of such liabilities or payment obligations with respect to such liabilities being treated as a bottom dollar payment obligation as described in paragraph (b)(3)(ii)(C)(*1*)(*i*), (*ii*), or (*iii*) of this section.

(*2*) *Exceptions*. A payment obligation is not a bottom dollar payment obligation merely because a maximum amount is placed on the partner's or related person's payment obligation, a partner's or related person's payment obligation is stated as a fixed percentage of every dollar of the partnership liability to which such obligation relates, or there is a right of proportionate contribution running between partners or related persons who are co-obligors with respect to a payment obligation for which each of them is jointly and severally liable.

(*3*) *Benefited party defined*. For purposes of §1.752-2, a *benefited party* is the person to whom a partner or related person has the payment obligation.

(D) *Disclosure of bottom dollar payment obligations*. A partnership must disclose to the Internal Revenue Service a bottom dollar payment obligation (including a bottom dollar payment obligation that is recognized under paragraph (b)(3)(ii)(B) of this section) with respect to a partnership liability on a completed Form 8275, Disclosure Statement, or successor form, attached to the return of the partnership for the taxable year in which the bottom dollar payment obligation is undertaken or modified, that includes all of the following information:

(*1*) A caption identifying the statement as a disclosure of a bottom dollar payment obligation under section 752.

(*2*) An identification of the payment obligation with respect to which disclosure is made (including whether the obligation is a guarantee, a reimbursement, an indemnity, or an obligation to restore a deficit balance in a partner's capital account).

(*3*) The amount of the payment obligation.

(*4*) The parties to the payment obligation.

(*5*) A statement of whether the payment obligation is treated as recognized for purposes of this paragraph (b)(3).

(*6*) If the payment obligation is recognized under paragraph (b)(3)(ii)(B) of this section, the facts and circumstances that clearly establish that a partner or related person is liable for up to 90 percent of the partner's or related person's initial payment obligation and, but for an indemnity, a reimbursement agreement, or a similar arrangement, the partner's or related person's initial payment obligation would have been recognized under this paragraph (b)(3).

(iii) *Special rule for indemnities and reimbursement agreements*. An indemnity, a reimbursement agreement, or a similar arrangement will be recognized under this paragraph (b)(3) only if, before taking into account the indemnity, reimbursement agreement, or similar arrangement, the indemnitee's or other benefited party's payment obligation is recognized under this paragraph (b)(3), or would be recognized under this paragraph (b)(3) if such person were a partner or related person.

* * *

(6) *Deemed satisfaction of obligation*. For purposes of determining the extent to which a partner or related person has a payment obligation and the economic risk of loss, it is assumed that all partners and related persons who have obligations to make payments (a payment obligor) actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate—

(i) A plan to circumvent or avoid the obligation under paragraph (j) of this section, or

(ii) That there is not a commercially reasonable expectation that the payment obligor will have the ability to make the required payments under the terms of the obligation if the obligation becomes due and payable as described in paragraph (k) of this section.

* * * * *

(f) *Examples*. * * * Unless otherwise provided, for purposes of paragraph (f)(1) through (9) of this section (*Examples 1* through *9*), assume that any obligation of a partner or related person to make a payment is recognized under paragraph (b)(3) of this section.

* * * * *

(9) [Reserved].

(10) *Example 10. Guarantee of first and last dollars*. (i) A, B, and C are equal members of a limited liability company, ABC, that is treated as a partnership for federal tax purposes. ABC borrows $1,000 from Bank. A guarantees payment of up to $300 of the ABC liability if any amount of the full $1,000 liability is not recovered by Bank. B guarantees payment of up to $200, but only if the Bank otherwise recovers less than $200. Both A and B waive their rights of contribution against each other.

(ii) Because A is obligated to pay up to $300 if, and to the extent that, any amount of the $1,000 partnership liability is not recovered by Bank, A's guarantee is not a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section. Therefore, A's payment obligation is recognized under paragraph (b)(3) of this section. The amount of A's economic risk of loss under §1.752-2(b)(1) is $300.

(iii) Because B is obligated to pay up to $200 only if and to the extent that the Bank otherwise recovers less than $200 of the $1,000 partnership liability, B's guarantee is a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and, therefore, is not recognized under paragraph (b)(3)(ii)(A) of this section. Accordingly, B bears no economic risk of loss under §1.752-2(b)(1) for ABC's liability.

(iv) In sum, $300 of ABC's liability is allocated to A under §1.752-2(a), and the remaining $700 liability is allocated to A, B, and C under §1.752-3.

(11) *Example 11. Indemnification of guarantees*. (i) The facts are the same as in paragraph (f)(10) of this section (*Example 10*), except that, in addition, C agrees to indemnify A up to $100 that A pays with respect to its guarantee and agrees to indemnify B fully with respect to its guarantee.

(ii) The determination of whether C's indemnity is recognized under paragraph (b)(3) of this section is made without regard to whether C's indemnity itself causes A's guarantee not to be recognized. Because A's obligation would be recognized but for the effect of C's indemnity and C is obligated to pay A up to the full amount of C's indemnity if A pays any amount on its guarantee of ABC's liability, C's indemnity of A's guarantee is not a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and, therefore, is recognized under paragraph (b)(3) of this section. The amount of C's economic risk of loss under §1.752-2(b)(1) for its indemnity of A's guarantee is $100.

(iii) Because C's indemnity is recognized under paragraph (b)(3) of this section, A is treated as liable for $200 only to the extent any amount beyond $100 of the partnership liability is not satisfied. Thus, A is not liable if, and to the extent, any amount of the partnership liability is not otherwise satisfied, and the exception in paragraph (b)(3)(ii)(B) of this section does not apply. As a result, A's guarantee is a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and is not recognized under paragraph (b)(3)(ii)(A) of this section. Therefore, A bears no economic risk of loss under §1.752-2(b)(1) for ABC's liability.

(iv) Because B's obligation is not recognized under paragraph (b)(3)(ii) of this section independent of C's indemnity of B's guarantee, C's indemnity is not recognized under paragraph (b)(3)(iii) of this section. Therefore, C bears no economic risk of loss under §1.752-2(b)(1) for its indemnity of B's guarantee.

(v) In sum, $100 of ABC's liability is allocated to C under §1.752-2(a) and the remaining $900 liability is allocated to A, B, and C under §1.752-3.

* * * * *

(j) * * *

(2) *Arrangements tantamount to a guarantee*—(i) *In general*. Irrespective of the form of a contractual obligation, a partner is considered to bear the economic risk of loss with respect to a partnership liability, or a portion thereof, to the extent that—

(A) The partner or related person undertakes one or more contractual obligations so that the partnership may obtain or retain a loan;

(B) The contractual obligations of the partner or related person significantly reduce the risk to the lender that the partnership will not satisfy its obligations under the loan, or a portion thereof; and

(C) With respect to the contractual obligations described in paragraphs (j)(2)(i)(A) and (B) of this section—

(*1*) One of the principal purposes of using the contractual obligations is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests; or

(*2*) Another partner, or a person related to another partner, enters into a payment obligation and a principal purpose of the arrangement is to cause the payment obligation described in paragraphs (j)(2)(i)(A) and (B) of this section to be disregarded under paragraph (b)(3) of this section.

(ii) *Economic risk of loss*. For purposes of this paragraph (j)(2), partners are considered to bear the economic risk of loss for a liability in accordance with their relative economic burdens for the liability pursuant to the contractual obligations. For example, a lease between a partner and a partnership that is not on commercially reasonable terms may be tantamount to a guarantee by the partner of the partnership liability.

(3) *Plan to circumvent or avoid an obligation*—(i) *General rule*. An obligation of a partner or related person to make a payment is not recognized under paragraph (b) of this section if the facts and circumstances evidence a plan to circumvent or avoid the obligation.

(ii) *Factors indicating plan to circumvent or avoid an obligation*. In the case of a payment obligation, other than an obligation to restore a deficit capital account upon liquidation of a partnership, paragraphs (j)(3)(ii)(A) through (G) of this section provide a non-exclusive list of factors that may indicate a plan to circumvent or avoid the payment obligation. The presence or absence of a factor is based on all of the facts and circumstances at the time the partner or related person makes the payment obligation or if the obligation is modified, at the time of the modification. For purposes of making determinations under this paragraph (j)(3), the weight to be given to any particular factor depends on the particular case and the presence or absence of a factor is not necessarily indicative of whether a payment obligation is or is not recognized under paragraph (b) of this section.

(A) The partner or related person is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, including, for example, restrictions on transfers for inadequate consideration or distributions by the partner or related person to equity owners in the partner or related person.

(B) The partner or related person is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party, including, for example, balance sheets and financial statements.

(C) The term of the payment obligation ends prior to the term of the partnership liability, or the partner or related person has a right to terminate its payment obligation, if the purpose of limiting the duration of the payment obligation is to terminate such payment obligation prior to the occurrence of an event or events that increase the risk of economic loss to the guarantor or benefited party (for example, termination prior to the due date of a balloon payment or a right to terminate that can be exercised because the value of loan collateral decreases). This factor typically will not be present if the termination of the obligation occurs by reason of an event or events that decrease the risk of economic loss to the guarantor or benefited party (for example, the payment obligation terminates upon the completion of a building construction project, upon the leasing of a building, or when certain income and asset coverage ratios are satisfied for a specified number of quarters).

(D) There exists a plan or arrangement in which the primary obligor or any other obligor (or a person related to the obligor) with respect to the partnership liability directly or indirectly holds money or other liquid assets in an amount that exceeds the reasonably foreseeable needs of such obligor (but not taking into account standard commercial insurance, for example, casualty insurance).

(E) The payment obligation does not permit the creditor to promptly pursue payment following a payment default on the partnership liability, or other arrangements with respect to the partnership liability or payment obligation otherwise indicate a plan to delay collection.

(F) In the case of a guarantee or similar arrangement, the terms of the partnership liability would be substantially the same had the partner or related person not agreed to provide the guarantee.

(G) The creditor or other party benefiting from the obligation did not receive executed documents with respect to the payment obligation from the partner or related person before, or within a commercially reasonable period of time after, the creation of the obligation.

(4) *Example*. The following example illustrates the principles of paragraph (j) of this section.

(i) In 2020, A, B, and C form a domestic limited liability company (LLC) that is classified as a partnership for federal tax purposes. Also in 2020, LLC receives a loan from a bank. A, B, and C do not bear the economic risk of loss with respect to that partnership liability, and, as a result, the liability is treated as nonrecourse under §1.752-1(a)(2) in 2020. In 2022, A guarantees the entire amount of the liability. The bank did not request the guarantee and the terms of the loan did not change as a result of the guarantee. A did not provide any executed documents with respect to A's guarantee to the bank. The bank also did not require any restrictions on asset transfers by A and no such restrictions exist.

(ii) Under paragraph (j)(3) of this section, A's 2022 guarantee (payment obligation) is not recognized under paragraph (b)(3) of this section if the facts and circumstances evidence a plan to circumvent or avoid the payment obligation. In this case, the following factors indicate a plan to circumvent or avoid A's payment obligation: the partner is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, such as restrictions on transfers for inadequate consideration or equity distributions; the partner is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party; in the case of a guarantee or similar arrangement, the terms of the liability are the same as they would have been without the guarantee; and the creditor did not receive executed documents with respect to the payment obligation from the partner or related person at the time the obligation was created. Absent the existence of other facts or circumstances that would weigh in favor of respecting A's guarantee, evidence of a plan to circumvent or avoid the obligation exists and, pursuant to paragraph (j)(3)(i) of this section, A's guarantee is not recognized under paragraph (b) of this section. As a result, LLC's liability continues to be treated as nonrecourse.

(k) *No reasonable expectation of payment*—(1) *In general*. An obligation of any partner or related person to make a payment is not recognized under paragraph (b) of this section if the facts and circumstances indicate that at the time the partnership must determine a partner's share of partnership liabilities under §§1.705-1(a) and 1.752-4(d) there is not a commercially reasonable expectation that the payment obligor will have the ability to make the required payments under the terms of the obligation if the obligation becomes due and payable. Facts and circumstances to consider in determining a commercially reasonable expectation of payment include factors a third party creditor would take into account when determining whether to grant a loan. For purposes of this section, a payment obligor includes an entity disregarded as an entity separate from its owner under section 856(i), section 1361(b)(3), or §§301.7701-1 through 301.7701-3 of this chapter (a disregarded entity), and a trust to which subpart E of part I of subchapter J of chapter 1 of the Code applies

(2) *Examples*. The following examples illustrate the principles of paragraph (k) of this section.

(i) *Example 1. Undercapitalization*. (A) In 2020, A forms a wholly owned domestic limited liability company, LLC, with a contribution of $100,000. A has no liability for LLC's debts, and LLC has no enforceable right to a contribution from A. Under §301.7701-3(b)(1)(ii) of this chapter, LLC is treated for federal tax purposes as a disregarded entity. Also in 2020, LLC contributes $100,000 to LP, a limited partnership with a calendar year taxable year, in exchange for a general partnership interest in LP, and B and C each contributes $100,000 to LP in exchange for a limited partnership interest in LP. The partnership agreement provides that only LLC is required to restore any deficit in its capital account. On January 1, 2021, LP borrows $300,000 from a bank and uses $600,000 to purchase nondepreciable property. The $300,000 is secured by the property and is also a general obligation of LP. LP makes payments of only interest on its $300,000 debt during 2021. LP has a net taxable loss in 2021, and, under §§1.705-1(a) and 1.752-4(d), LP determines its partners' shares of the $300,000 debt at the end of its taxable year, December 31, 2021. As of that date, LLC holds no assets other than its interest in LP.

(B) Because LLC is a disregarded entity, A is treated as the partner in LP for federal income tax purposes. Only LLC has an obligation to make a payment on account of the $300,000 debt if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, paragraph (k) of this section is applied to the LLC and not to A. LLC has no assets with which to pay if the payment obligation becomes due and payable. Because there is no commercially reasonable expectation that LLC will be able to satisfy its payment obligation, LLC's obligation to restore its deficit capital account is not recognized under paragraph (b) of this section. As a result, LP's $300,000 debt is characterized as nonrecourse under §1.752-1(a)(2) and is allocated among A, B, and C under §1.752-3.

(ii) *Example 2. Disregarded entity with ability to pay*. (A) The facts are the same as in paragraph (k)(2)(i) of this section (*Example 1*), except LLC also holds real property worth $475,000 subject to a $200,000 liability. Additionally, LLC reasonably projects to earn $20,000 of net rental income per year from such real property.

(B) Because LLC is a disregarded entity, A is treated as the partner in LP for federal income tax purposes. Only LLC has an obligation to make a payment on account of the $300,000 debt if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, paragraph (k) of this section is applied to the LLC and not to A. Because there is a commercially reasonable expectation that LLC will be able to satisfy its payment obligation, LLC's obligation to restore its deficit capital account is recognized under paragraph (b) of this section. As a result, LP's $300,000 debt is characterized as recourse under §1.752-1(a)(1) and is allocated to A under §1.752-2.

(l) *Applicability dates*. (1) Paragraphs (a) and (h)(3) of this section apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to that date. The rules applicable to liabilities incurred or assumed (or pursuant to a written binding contract in effect) prior to October 11, 2006, are contained in §1.752-2 in effect prior to October 11, 2006, (see 26 CFR part 1 revised as of April 1, 2006). Paragraphs (b)(6), (j)(3) and (4), and (k) of this section apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after October 9, 2019, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date. However, taxpayers may apply paragraphs (b)(6), (j)(3) and (4), and (k) of this section to all of their liabilities as of the beginning of the first taxable year of the partnership ending on or after October 5, 2016. The rules applicable to liabilities incurred or assumed (or pursuant to a written binding contract in effect) prior to October 9, 2019, are contained in §1.752-2 in effect prior to October 9, 2019, (see 26 CFR part 1 revised as of April 1, 2019).

(2) Paragraphs (b)(3), (f)(10) and (11), and (j)(2) of this section apply to liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken with respect to a partnership liability on or after October 5, 2016, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date. Partnerships may apply paragraphs (b)(3), (f)(10) and (11), and (j)(2) of this section to all of their liabilities as of the beginning of the first taxable year of the partnership ending on or after October 5, 2016. The rules applicable to liabilities incurred or assumed (or subject to a written binding contract in effect) prior to October 5, 2016, are contained in §1.752-2 in effect prior to October 5, 2016, (see 26 CFR part 1 revised as of April 1, 2016).

(3) If a partner has a share of a recourse partnership liability under §1.752-2(a) as a result of bearing the economic risk of loss under §1.752-2(b) immediately prior to October 5, 2016 (Transition Partner), and such liability is modified or refinanced, the partnership (Transition Partnership) may choose not to apply paragraphs (b)(3), (f)(10) and (11), and (j)(2)(i)(C)(*2*) of this section to the extent the amount of the Transition Partner's share of liabilities under §1.752-2(a) as a result of bearing the economic risk of loss under §1.752-2(b) immediately prior

to October 5, 2016, exceeds the amount of the Transition Partner's adjusted basis in its partnership interest as determined under §1.705-1 at such time (Grandfathered Amount). See also §1.704-2(g)(3). A liability is modified or refinanced for purposes of this paragraph (l) to the extent that the proceeds of a partnership liability (the refinancing debt) are allocable under the rules of §1.163-8T to payments discharging all or part of any other liability (pre-modification liability) of that partnership or there is a significant modification of that liability as provided under §1.1001-3. A Transition Partner that is a partnership, S corporation, or a business entity disregarded as an entity separate from its owner under section 856(i) or 1361(b)(3) or §§301.7701-1 through 301.7701-3 of this chapter ceases to qualify as a Transition Partner if the direct or indirect ownership of that Transition Partner changes by 50 percent or more. The Transition Partnership may continue to apply the rules under §1.752-2 in effect prior to October 5, 2016, with respect to a Transition Partner for payment obligations described in §1.752-2(b) to the extent of the Transition Partner's adjusted Grandfathered Amount for the seven-year period beginning October 5, 2016. The termination of a Transition Partnership under section 708(b)(1)(B) and applicable regulations prior to January 1, 2018, does not affect the Grandfathered Amount of a Transition Partner that remains a partner in the new partnership (as described in §1.708-1(b)(4)), and the new partnership is treated as a continuation of the Transition Partnership for purposes of this paragraph (l)(3). However, a Transition Partner's Grandfathered Amount is reduced (not below zero), but never increased by—

(i) Upon the sale of any property by the Transition Partnership, an amount equal to the excess of any gain allocated for federal income tax purposes to the Transition Partner by the Transition Partnership (including amounts allocated under section 704(c) and applicable regulations) over the product of the total amount realized by the Transition Partnership from the property sale multiplied by the Transition Partner's percentage interest in the partnership; and

(ii) An amount equal to any decrease in the Transition Partner's share of liabilities to which the rules of this paragraph (l)(3) apply, other than by operation of paragraph (l)(3)(i) of this section.

§1.752-2T [Amended]

Par. 6. In §1.752-2T, paragraphs (a) and (b), (c)(1) and (2), (d) through (k), (l)(1) through (3), and (m)(1) are removed and reserved.

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

Approved: October 1, 2019.

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

(Filed by the Office of the Federal Register on October 4, 2019, 4:15 p.m., and published in the issue of the Federal Register for October 9, 2019, 84 F.R. 54014)

Part III

Temporary Regulations under Section 385 on the Treatment of Certain Interests in Corporations as Stock or Indebtedness

Notice 2019-58

On October 21, 2016, the Treasury Department and the IRS published T.D. 9790 in the Federal Register (81 FR 72858), which included final and temporary regulations under section 385 addressing documentation in §1.385-2 and certain debt that is issued to a controlling shareholder in a distribution or in another related-party transaction in §1.385-3. On the same date, the Treasury Department and the IRS also published a notice of proposed rulemaking (REG-130314-16) in the Federal Register (81 FR 72751) (the 2016 Proposed Regulations) by cross-reference to the temporary regulations under section 385, which include §§1.385-3T and 1.385-4T (the Temporary Regulations).

The Temporary Regulations expire on October 13, 2019. *See* section 7805(e); §1.385-3T(l); §1.385-4T(h). The 2016 Proposed Regulations are proposed to apply to taxable years ending on or after January 19, 2017; in contrast to the Temporary Regulations, the 2016 Proposed Regulations do not expire. A taxpayer may rely on the 2016 Proposed Regulations for periods following the expiration of the Temporary Regulations until further notice is given, provided that the taxpayer consistently applies the rules in the 2016 Proposed Regulations in their entirety.

The principal author of this notice is Azeka J. Abramoff of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Abramoff at (202) 317-6938 (not a toll free number).

Rev. Proc. 2019-41

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under § 42(h)(3)(D) of the Internal Revenue Code for calendar year 2019.

SECTION 2. BACKGROUND

Rev. Proc. 92-31, 1992-1 C.B. 775, provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92-31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 2019.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 2019 is as follows:

Qualified State	*Amount Allocated*
Alabama	50,449
Arizona	74,020
California	408,277
Connecticut	36,874
Delaware	9,982
Florida	219,835
Georgia	108,574
Idaho	18,106
Illinois	131,504
Indiana	69,068
Maryland	62,368
Massachusetts	71,239
Michigan	103,170
Montana	10,964
Nebraska	19,912
New Jersey	91,947
New Mexico	21,627
New York	201,700

Qualified State	Amount Allocated
North Carolina	107,172
Ohio	120,649
Oklahoma	40,697
Pennsylvania	132,185
Rhode Island	10,913
South Dakota	9,106
Texas	296,238
Utah	32,627
Vermont	6,464
Virginia	87,913
Washington	77,777
West Virginia	18,638
Wisconsin	60,003

EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state's housing credit ceiling for calendar year 2019.

DRAFTING INFORMATION

The principal author of this revenue procedure is YoungNa Lee of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Ms. Lee at (202) 317-4137 (not a toll-free number).

Section 42.—Low-Income Housing Credit

26 CFR 1.42-14. Allocation rules for post-1989 housing credit ceiling amounts.

Guidance is provided to state housing credit agencies of qualified states that request an allocation of unused housing credit carryover under section 42(h)(3)(D) of the Internal Revenue Code. See Rev. Proc. 2019-41.

Part IV

Guidance on the Transition From Interbank Offered Rates to Other Reference Rates

REG-118784-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance on the tax consequences of the transition to the use of reference rates other than interbank offered rates (IBORs) in debt instruments and non-debt contracts. The proposed regulations are necessary to address the possibility that an alteration of the terms of a debt instrument or a modification of the terms of other types of contracts to replace an IBOR to which the terms of the debt instrument or other contract refers with a new reference rate could result in the realization of income, deduction, gain, or loss for Federal income tax purposes or could result in other tax consequences. The proposed regulations will affect parties to debt instruments and other contracts that reference an IBOR.

DATES: Written or electronic comments and requests for a public hearing must be received by November 25, 2019.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-118784-18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-118784-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-118784-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Caitlin Holzem at (202) 317-4391; concerning submissions of comments and requesting a hearing, Regina L. Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under sections 860G, 882, 1001, and 1275 of the Internal Revenue Code (Code).

1. *Elimination of IBORs*

On July 27, 2017, the U.K. Financial Conduct Authority, the U.K. regulator tasked with overseeing the London interbank offered rate (LIBOR), announced that all currency and term variants of LIBOR, including U.S.-dollar LIBOR (USD LIBOR), may be phased out after the end of 2021. The Financial Stability Board (FSB) and the Financial Stability Oversight Council (FSOC) have publicly acknowledged that in light of the prevalence of USD LIBOR as the reference rate in a broad range of financial instruments, the probable elimination of USD LIBOR has created risks that pose a potential threat to the safety and soundness of not only individual financial institutions, but also to financial stability generally. In its 2014 report "Reforming Major Interest Rate Benchmarks," the FSB discussed the problems associated with key IBORs and made recommendations to address these problems, including the development and adoption of nearly risk-free reference rates to replace IBORs. The FSB and FSOC have recognized that a sudden cessation of a widely used reference rate could cause considerable disruptions in the marketplace and might adversely affect the normal functioning of a variety of markets in the United States, including business and consumer lending and the derivatives markets.

The Alternative Reference Rates Committee (ARRC), whose ex-officio members include the Board of Governors of the Federal Reserve System, the Treasury Department, the Commodity Futures Trading Commission, and the Office of Financial Research, was convened by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York to identify alternative reference rates that would be both more robust than USD LIBOR and that would comply with standards such as the International Organization of Securities Commissions' "Principles for Financial Benchmarks." The ARRC was also responsible for developing a plan to facilitate the voluntary acceptance of the alternative reference rate or rates that were chosen. On March 5, 2018, the ARRC published a report that summarizes the work done earlier to select the Secured Overnight Financing Rate (SOFR) as the replacement for USD LIBOR. The Federal Reserve Bank of New York began publishing SOFR daily as of April 3, 2018, in cooperation with the Office of Financial Research. In addition, the Chicago Mercantile Exchange and other entities have launched trading in SOFR futures and have begun clearing for over-the-counter SOFR swaps. Although SOFR is calculated from overnight transactions, it is possible that one or more term rates based on SOFR derivatives may be added in the future.

Other jurisdictions have also been working toward replacing the LIBOR associated with their respective currencies. The Working Group on Sterling Risk-Free Reference Rates in the United Kingdom chose the Sterling Overnight Index Average (SONIA) to replace British pound sterling LIBOR; the Study Group on Risk-Free Reference Rates in Japan chose the Tokyo Overnight Average Rate (TONAR) to replace yen LIBOR and to serve as an alternative to the Tokyo Interbank Offered Rate (TIBOR); and the National Working

Group in Switzerland selected the Swiss Average Rate Overnight (SARON) to replace Swiss franc LIBOR. Alternatives for the relevant IBOR rate have also been selected for Australia, Canada, Hong Kong, and the Eurozone. Other countries are at various stages of selecting a reference rate to replace their respective versions of IBOR.

2. *Letters on the Tax Implications of the Elimination of IBORs on Debt Instruments and Non-Debt Contracts*

On April 8, 2019, and June 5, 2019, the ARRC submitted to the Treasury Department and the IRS documents that identify various potential tax issues associated with the elimination of IBORs and request tax guidance to address those issues and to facilitate an orderly transition (ARRC letters). The ARRC stated that existing debt instruments and derivatives providing for IBOR-based payments must be amended to address the coming elimination of IBORs. The ARRC indicated that these amendments will likely take one of two forms. First, the parties may alter the instruments to replace the IBOR-referencing rate with another rate, such as one based on SOFR. Second, the parties may alter the instruments to replace an IBOR-referencing fallback rate with another fallback rate upon the discontinuance of the IBOR or at some other appropriate time. The ARRC describes fallback provisions as the provisions specifying what is to occur if an IBOR is permanently discontinued or is judged to have deteriorated to an extent that its relevance as a reliable benchmark has been significantly impaired. The ARRC notes that, regardless of which of these two forms the amendment takes, the rate that replaces the IBOR-referencing rate may include "(i) appropriate adjustments to the spread above the base reference rate in order to account for the expected differences between the two base reference rates (generally representing term premium and credit risk) and/or (ii) a one time, lump-sum payment in lieu of a spread adjustment." The ARRC also stated that newer debt instruments and derivatives may already include fallback provisions that anticipate the elimination of an IBOR and provide a methodology for changing the rate when the relevant IBOR becomes unreliable or ceases to exist.

The ARRC letters urged broad and flexible tax guidance in this area. The ARRC letters requested guidance on specific tax issues that arise as a result of these efforts to transition from IBORs to alternative rates. The ARRC first asked that a debt instrument, derivative, or other contract not be treated as exchanged under section 1001 when the terms of the instrument are amended either to replace an IBOR-referencing rate or to include a fallback rate in anticipation of the elimination of the relevant IBOR. The ARRC noted that these same amendments could cause a taxpayer with a synthetic debt instrument under §1.1275-6 to be treated as legging out of the integrated transaction, and it also sought clarification on the source and character of a one-time payment in lieu of a spread adjustment on a derivative. The ARRC recommended treating SOFR, similar replacement rates for IBOR-referencing rates in other currencies, and potentially any qualified floating rate under §1.1275-5 as permitted alternative reference rates to IBOR-referencing rates. The ARRC further requested that alteration of a regular interest in a real estate mortgage investment conduit (REMIC) to replace an IBOR-referencing rate or to change fallback provisions not prevent the regular interest from having fixed terms on the startup day, and that the existence and exercise of a fallback provision not prevent a variable interest rate on a regular interest in a REMIC from being a permitted variable rate under §1.860G-1. Additionally, the ARRC suggested that, for the purpose of determining the amount and timing of original issue discount (OID) on a debt instrument, an IBOR-referencing qualified floating rate and the fallback rate that replaces the IBOR-referencing rate should be treated as a single qualified floating rate. Finally, the ARRC requested that the reference to 30-day LIBOR in §1.882-5(d)(5)(ii)(B) be amended so that taxpayers may continue to use the simplified method of computing excess interest permitted under that section. The Treasury Department and the IRS received letters from the Structured Finance Industry Group and the Real Estate Roundtable articulating concerns similar to those set forth in the ARRC letters. The comment letters also raised certain issues that are beyond the scope of this regulation.

3. *Tax Implications of the Elimination of IBORs on Debt Instruments and Non-Debt Contracts*

The following subsections discuss the primary tax issues raised by changes to the terms of debt instruments and non-debt contracts in anticipation of the elimination of IBORs.

A. Section 1001

Section 1001 provides rules for determining the amount and recognition of gain or loss from the sale or other disposition of property. The regulations under section 1001 generally provide that gain or loss is realized upon the exchange of property for other property differing materially either in kind or in extent. See §1.1001-1(a). In the case of a debt instrument, §1.1001-3(b) provides that a significant modification of the debt instrument results in an exchange of the original debt instrument for a modified debt instrument that differs materially either in kind or in extent for purposes of §1.1001-1(a). Under §1.1001-3(c), a modification is generally any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the issuer or a holder of a debt instrument. However, a modification generally does not include an alteration of a legal right or obligation that occurs by operation of the terms of a debt instrument. Section 1.1001-3(a)(1) provides that the rules of §1.1001-3 apply to any modification of a debt instrument, regardless of whether the modification takes the form of an amendment to the terms of the debt instrument or an exchange of a new debt instrument for an existing debt instrument. An alteration of a legal right or obligation that is treated as a modification must be tested for significance under §1.1001-3(e). Consequently, changing the interest rate index referenced in a U.S. dollar-denominated debt instrument from USD LIBOR to SOFR if no provision has been made in the terms of the debt instrument for such a change is an alteration of the terms of the debt instrument that could be treated as a significant modification and result in a tax realization event, even when USD LIBOR no longer exists.

Other than §1.1001-4, which generally prescribes the tax consequences to the nonassigning counterparty when there is a transfer or assignment of a derivative contract by a dealer or a clearinghouse, and §1.1001-5, which addresses the conversion of legacy currencies to the euro, there are no regulations that specifically address when a modification of a derivative or other non-debt contract creates a realization event. This absence of regulations has led to concern that modifying a non-debt contract to reflect the elimination of an IBOR, such as changing the floating rate index referenced in an interest rate swap contract from USD LIBOR to SOFR, could cause a deemed termination of the non-debt contract for tax purposes.

Moreover, a modification of the fallback provisions of a debt instrument or non-debt contract to address the possibility of an IBOR being eliminated might require the parties to recognize income, deduction, gain, or loss. For example, if the terms of a derivative provide for payments at an IBOR-referencing rate but contain no fallback provision, a modification to the terms of the derivative to add a fallback to the IBOR-referencing rate could cause a deemed termination of the derivative. Likewise, if the terms of a debt instrument provide for an IBOR-referencing fallback rate, an alteration of the terms of the debt instrument to replace the IBOR-referencing fallback rate with another fallback rate could cause a deemed exchange of the debt instrument.

B. Integrated Transactions and Hedges

A debt instrument and one or more hedges may be treated in certain circumstances as a single, integrated instrument for certain specified purposes. For example, §1.1275-6 describes the circumstances under which a debt instrument may be integrated with a hedge for the purpose of determining the amount and timing of the taxpayer's income, deduction, gain, or loss. Sections 1.988-5(a) (regarding foreign currency transactions) and 1.148-4(h) (regarding arbitrage investment restrictions on tax-exempt bonds issued by State and local governments) similarly provide rules by which a debt instrument may be integrated with a hedge for a specific purpose. In each of these cases, amending an IBOR-referencing debt instrument or hedge to address the elimination of the IBOR may cause a deemed termination or legging out of the integrated hedge that in effect dissolves the integrated instrument into its component parts, which may yield undesirable tax consequences or recognition events for the parties to those instruments.

Similarly, §1.446-4 provides rules by which taxpayers determine the timing of income, deduction, gain, or loss attributable to a hedging transaction. These rules generally state that the method of accounting used by a taxpayer for a hedging transaction must reasonably match the timing of income, deduction, gain, or loss from the hedging transaction with the timing of the income, deduction, gain, or loss from the item or items being hedged. If a taxpayer hedges an item and later terminates the item but keeps the hedge, the taxpayer must match the built-in gain or loss on the hedge to the gain or loss on the terminated item. Accordingly, amending the terms of a debt instrument or hedge to address the elimination of an IBOR could affect the timing of gain or loss under §1.446-4 if the amendment results in an exchange under section 1001.

C. Source and Character of a One-Time Payment

The ARRC letters pointed out that, when parties alter the terms of a debt instrument or modify the terms of a non-debt contract to replace a rate referencing an IBOR, the alteration or modification may consist not only of the replacement of the IBOR with a new reference rate such as SOFR but also of an adjustment to the existing spread to account for the differences between the IBOR and the new reference rate. Alternatively, in lieu of (or in addition to) an adjustment to the spread, the parties may agree to a one-time payment as compensation for any reduction in payments attributable to the differences between the IBOR and the new reference rate. In the latter case, questions arise about the source and character of this one-time payment for various purposes of the Internal Revenue Code, such as the withholding rules in sections 1441 and 1442.

D. Grandfathered Debt Instruments and Non-Debt Contracts

The requirements of certain statutes and regulations do not apply to debt instruments and non-debt contracts issued before a specific date. For example, an obligation issued on or before March 18, 2012, is not a registration-required obligation under section 163(f) if the obligation was issued under certain arrangements reasonably designed to ensure that the obligation was sold only to non-U.S. persons. If such an obligation is modified after March 18, 2012, in a manner that results in an exchange for purposes of §1.1001-1(a), the modified obligation is treated as reissued and will be a registration-required obligation unless otherwise excepted under section 163(f)(2)(A). Likewise, payments made on certain debt instruments and non-debt contracts outstanding on July 1, 2014, (grandfathered obligations) are exempt from withholding requirements that may otherwise apply under chapter 4 of the Code, subject to any material modification of a grandfathered obligation that results in the obligation not being treated as outstanding on July 1, 2014. Accordingly, if a debt instrument is altered or a non-debt contract is modified to replace an IBOR-referencing rate in anticipation of the elimination of the IBOR, the debt instrument or non-debt contract may be treated as reissued as a consequence of the alteration or modification and therefore subject to the statute or regulation from which it was previously exempt.

E. OID and Qualified Floating Rate

Section 1.1275-5 defines a variable rate debt instrument (VRDI) and provides rules for determining the amount and accrual of qualified stated interest and OID on a VRDI. Under §1.1275-5(b), a VRDI may provide for stated interest at one or more qualified floating rates. A variable rate is generally a qualified floating rate if variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds. The rate may measure contemporaneous variations in borrowing costs for the issuer of the debt instrument or for issuers in general. However, a multiple of a qualified floating rate is not a qualified floating rate, except as permitted within limited parameters. If a debt instrument provides for two or more qualified floating rates that can reasonably be expected to have approximately the same values throughout the term of the instrument, the qualified floating rates together constitute a single qualified floating rate. Under §1.1275-5(e)(2), if a VRDI provides for stated interest at a single qualified floating rate and certain other requirements are satisfied, the amount of any OID that accrues during an accrual period is determined under the rules applicable to fixed rate debt instruments by assuming that the qualified floating rate is a fixed rate equal to the value, as of the issue date, of the qualified floating rate.

Section 1.1275-2(h) describes the treatment under sections 1271 through 1275 and the regulations under those sections of a debt instrument with respect to which one or more payments are subject to a remote contingency. Section 1.1275-2(h)(2) provides that a contingency is remote if there is a remote likelihood that the contingency will occur and that, in such a case, it is assumed that the contingency will not occur. In the event that a remote contingency actually occurs, §1.1275-2(h)(6) generally provides that the debt instrument, including a VRDI, that undergoes this "change in circumstances" is treated as retired and then reissued for purposes of sections 1272 and 1273.

In general, if a debt instrument provides for a floating rate of interest and the debt instrument does not qualify as a VRDI, the debt instrument is a contingent payment debt instrument (CPDI) that is subject to more complex and less favorable rules under §1.1275-4. For example, under §1.1275-4, all of the stated interest is OID and the holder and issuer recognize interest income or deductions at times other than when cash payments are made. In addition, if a debt instrument that provides for a floating rate of interest is subject to a contingency that is not a remote contingency, the instrument may be a CPDI. Even if the contingency is remote, if the contingency occurs, the debt instrument is treated as retired and reissued for purposes of the OID rules. In both cases, the treatment of the contingency affects whether the debt instrument has OID and, if so, the amount of the OID and the accruals of the OID over the term of the debt instrument.

The transition to alternative rates, such as SOFR, in connection with the phase-out of IBORs has raised questions under the OID rules. For example, it is not clear whether certain debt instruments that reference IBOR qualify as VRDIs or whether they are subject to non-remote contingencies that must be taken into account.

F. REMICs

Section 860G(a)(1) provides in part that a regular interest in a REMIC must be issued on the startup day with fixed terms. Section 1.860G-1(a)(4) clarifies that a regular interest has fixed terms on the startup day if, on the startup day, the REMIC's organizational documents irrevocably specify, among other things, the interest rate or rates used to compute any interest payments on the regular interest. Accordingly, an alteration of the terms of the regular interest to change the rate or fallback provisions in anticipation of the cessation of an IBOR could preclude the interest from being a regular interest.

Section 860G(a)(1) also provides in part that interest payments on a regular interest in a REMIC may be payable at a variable rate only to the extent provided in regulations and that a regular interest must unconditionally entitle the holder to receive a specified principal amount. Section 1.860G-1(a)(3) describes the variable rates permitted for this purpose, and §1.860G-1(a)(5) confirms that the principal amount of a regular interest generally may not be contingent. Notwithstanding these limitations on the payment of principal and interest on a regular interest in a REMIC, §1.860G-1(b)(3) lists certain contingencies affecting the payment of principal and interest that do not prevent an interest in a REMIC from being a regular interest. The list of excepted contingencies does not, however, include a fallback rate that is triggered by an event, such as the elimination of IBOR, that is likely to occur. Nor does the list expressly include the contingent reduction of principal or interest payments to offset costs incurred by amending a regular interest to replace a rate that refers to an IBOR or by adding a fallback rate in anticipation of the elimination of the relevant IBOR.

Subject to certain exceptions, section 860G(d) imposes a tax equal to 100 percent of amounts contributed to a REMIC after the startup day. If a party other than the REMIC pays costs incurred by the REMIC after the startup day, that payment could be treated as a contribution to the REMIC subject to the tax under section 860G(d).

G. Interest Expense of a Foreign Corporation

A foreign corporation applies §1.882-5 to determine its interest expense allocable under section 882(c) to income that is effectively connected with the conduct of a trade or business within the United States. If a foreign corporation uses the method described in §1.882-5(b) through (d), that foreign corporation could have U.S.-connected liabilities that exceed U.S.-booked liabilities (excess U.S.-connected liabilities). When a foreign corporation has excess U.S.-connected liabilities, §1.882-5(d)(5)(ii)(A) generally provides that the interest rate that applies to the excess U.S.-connected liabilities is the foreign corporation's average U.S.-dollar borrowing cost on all U.S.-dollar liabilities other than its U.S.-booked liabilities. Alternatively, §1.882-5(d)(5)(ii)(B) provides that a foreign corporation that is a bank, may elect to use a published average 30-day LIBOR for the year instead of determining its average U.S.-dollar borrowing cost. Because the election provided in §1.882-5(d)(5)(ii)(B) only permits a foreign corporation that is a bank to elect a rate that references 30-day LIBOR, the current election will not be available when LIBOR is phased out.

Explanation of Provisions

1. *Proposed Substantive Amendments to the Regulations*

The Treasury Department and the IRS have determined that it is appropriate to provide guidance on the tax issues discussed earlier in this preamble in order to minimize potential market disruption and to facilitate an orderly transition in connection with the phase-out of IBORs and the attendant need for changes in debt instruments and other non-debt contracts to implement this transition. The Treasury Department and the IRS expect that this guidance will reduce Federal income tax uncertainties and minimize taxpayer burden associated with this transition.

A. Section 1001

The proposed regulations under §1.1001-6(a) generally provide that, if the terms of a debt instrument are altered or the terms of a non-debt contract, such as a derivative, are modified to replace, or to provide a fallback to, an IBOR-referencing rate and the alteration or modification does not change the fair market value of the debt instrument or non-debt contract or the currency of the reference rate, the alteration or modification does not result in the realization of income, deduction, gain, or loss for purposes of section 1001. The Treasury Department and the IRS intend that the proposed rules in §1.1001-6(a), as with other regulations under section 1001, apply to both the issuer and holder of a debt instrument and to each party to a non-debt contract. The proposed rules in §1.1001-6(a) also apply regardless of whether the alteration or modification occurs by an amendment to the terms of the debt instrument or non-debt contract or by an exchange of a new debt instrument or non-debt contract for the existing one.

Section 1.1001-6(a)(1) of the proposed regulations provides that altering the terms of a debt instrument to replace a rate referencing an IBOR with a qualified rate (qualified rates are discussed in detail later in this preamble) is not treated as a modification and therefore does not result in a deemed exchange of the debt instrument for purposes of §1.1001-3. This same rule applies to "associated alterations," which are alterations that are both associated with the replacement of the IBOR-referencing rate and reasonably necessary to adopt or implement that replacement. One example of an associated alteration is the addition of an obligation for one party to make a one-time payment in connection with the replacement of the IBOR-referencing rate with a qualified rate to offset the change in value of the debt instrument that results from that replacement.

Section 1.1001-6(a)(2) of the proposed regulations provides that modifying a non-debt contract to replace a rate referencing an IBOR with a qualified rate is not treated as a deemed exchange of property for other property differing materially in kind or extent for purposes of §1.1001-1(a). The rule also applies to "associated modifications," which differ from associated alterations only in that they relate to non-debt contracts. The principal example of a non-debt contract for purposes of the proposed regulations is a derivative contract, but the category is also intended to include any other type of contract (such as a lease) that may refer to an IBOR and that is not debt. Thus, for example, if an interest rate swap is modified to change the floating rate leg of the swap from Overnight USD LIBOR plus 25 basis points to an alternative rate referencing SOFR that meets the requirements for a qualified rate under the proposed regulations (including the requirement that the fair market value of the swap contract after the modification is substantially equivalent to the fair market value of the swap contract before the modification), that modification would not be treated as an exchange of property for other property differing materially in kind or extent and would therefore not be an event that results in the realization of income, deduction, gain or loss under §1.1001-1(a).

Section 1.1001-6(a)(3) of the proposed regulations provides that an alteration to the terms of a debt instrument to include a qualified rate as a fallback to an IBOR-referencing rate and any associated alteration are not treated as modifications and therefore do not result in an exchange of the debt instrument for purposes of §1.1001-3. In addition, an alteration to the terms of a debt instrument by which an IBOR-based fallback rate is replaced with a different fallback rate that is a qualified rate and any associated alteration are also not treated as modifications. Similar rules provide that these same changes to a non-debt contract do not result in the exchange of property for other property differing materially in kind or extent for purposes of §1.1001-1(a).

A coordination rule in §1.1001-6(a)(4) of the proposed regulations makes clear that any alteration to the terms of a debt instrument that is not given special treatment under either §1.1001-6(a)(1) or (3) is subject to the ordinary operation of §1.1001-3. The proposed regulations provide a similar rule for non-debt contracts. These proposed rules contemplate that when an alteration or modification not described in §1.1001-6(a)(1), (2), or (3) occurs at the same time as the alteration or modification described in those paragraphs, the alteration or modification described in §1.1001-6(a)(1), (2), or (3) is treated as part of the existing terms of the debt instrument or non-debt contract and, consequently, becomes part of the baseline against which the alteration or modification not described in §1.1001-6(a)(1), (2), or (3) is tested.

Section 1.1001-6(b) of the proposed regulations sets forth the rules for determining whether a rate is a qualified rate. Section 1.1001-6(b)(1) lists the rates that may be qualified rates for purposes of §1.1001-6, provided that they satisfy the requirements set forth in §1.1001-6(b)(2) and (3). The list of potential qualified rates in §1.1001-6(b)(1) includes a qualified floating rate as defined in §1.1275-5(b), except that for this purpose a multiple of a qualified floating rate is considered a qualified floating rate. This list also includes any rate selected, endorsed or recommended by the central bank, reserve bank, monetary authority or similar institution (including a committee or working group thereof) as a replacement for an IBOR or its local currency equivalent in that jurisdiction. To avoid any uncertainty on the question of whether the rates identified in §1.1001-6(b)(1)(i) through (viii) may be qualified rates, those rates are individually enumerated even though each is a qualified floating rate, as defined in §1.1275-5(b), and each has been selected by a central bank, reserve bank, monetary authority or similar institution as a replacement for an IBOR or its local currency equivalent in that jurisdiction. The proposed regulations further provide that a rate that is determined by reference to one of the rates listed in §1.1001-6(b)(1) may also be a qualified rate. For example, a rate equal to the compound average of SOFR over the past 30 days may be a qualified rate because that rate is determined by reference to SOFR, which is listed in §1.1001-6(b)(1). To retain the flexibility to respond to future developments, proposed §1.1001-6(b)(1)(xii) provides authority to add a rate to this list by identifying the new rate in guidance published in the Internal Revenue Bulletin.

A rate described in §1.1001-6(b)(1) of the proposed regulations is not a qualified rate if it fails to satisfy the requirement of §1.1001-6(b)(2)(i). Section 1.1001-6(b)(2)(i) of the proposed regulations generally requires that the fair market value of the debt instrument or non-debt contract after the relevant alteration or modification must be substantially equivalent to the fair market value before that alteration or modification. The purpose of this requirement is to ensure that the alterations or modifications described in §1.1001-6(a)(1) through (3) are generally no broader than is necessary to replace the IBOR in the terms of the debt instrument or non-debt contract with a new reference rate. However, the Treasury Department and the IRS recognize that the fair market value of a debt instrument or non-debt contract may be difficult to determine precisely and intend that the proposed regulations broadly facilitate the transition away from IBORs. Accordingly, the proposed regulations provide that the fair market value of a debt instrument or derivative may be determined by any reasonable valuation method, as long as that reasonable valuation method is applied consistently and takes into account any one-time payment made in lieu of a spread adjustment.

To further ease compliance with the value equivalence requirement in §1.1001-6(b)(2)(i), the proposed regulations provide two safe harbors and reserve the authority to provide additional safe harbors in guidance published in the Internal Revenue Bulletin. Under the first safe harbor, the value equivalence requirement is satisfied if at the time of the alteration the historic average of the IBOR-referencing rate is within 25 basis points of the historic average of the rate that replaces it. The parties may use any reasonable method to compute an historic average, subject to two limitations. First, the lookback period from which the historic data are drawn must begin no earlier than 10 years before the alteration or modification and end no earlier than three months before the alteration or modification. Second, once a lookback period is established, the historic average must take into account every instance of the relevant rate published during that period. For example, if the lookback period is comprised of the calendar years 2016 through 2020 and the relevant rate is 30-day USD LIBOR, the historic average of that rate must take into account each of the 60 published instances of 30-day USD LIBOR over the five-year lookback period. Alternatively, the parties may compute the historic average of a rate in accordance with an industry-wide standard, such as a standard for determining an historic average set forth by the International Swaps and Derivatives Association or the ARRC for this or a similar purpose. In any application of this safe harbor, the parties must use the same methodology and lookback period to compute the historic average for each of the rates to be compared.

Under the second safe harbor, the value equivalence requirement of §1.1001-6(b)(2)(i) is satisfied if the parties to the debt instrument or non-debt contract are not related and, through bona fide, arm's length negotiations over the alteration or modification, determine that the fair market value of the altered debt instrument or modified non-debt contract is substantially equivalent to the fair market value of the debt instrument or non-debt contract before the alteration or modification. In determining the fair market value of an altered debt instrument or modified non-debt contract, the parties must take into account the value of any one-time payment made in lieu of a spread adjustment.

A rate described in §1.1001-6(b)(1) of the proposed regulations is also not a qualified rate if it fails to satisfy the requirement in §1.1001-6(b)(3). This paragraph generally requires that any interest rate benchmark included in the replacement rate and the IBOR referenced in the replaced rate are based on transactions conducted in the same currency or are otherwise reasonably expected to measure contemporaneous variations in the cost of newly borrowed funds in the same currency. As is the case with the value equivalence requirement under §1.1001-6(b)(2)(i), this requirement is intended to ensure that the alterations or modifications described in §1.1001-6(a)(1) through (3) are no broader than necessary to address the elimination of the relevant IBOR.

B. Integrated Transactions and Hedges

Section 1.1001-6(c) of the proposed regulations confirms that a taxpayer is permitted to alter the terms of a debt instrument or modify one or more of the other components of an integrated or hedged transaction to replace a rate referencing an IBOR with a qualified rate without affecting the tax treatment of either the underlying transaction or the hedge, provided that the integrated or hedged transaction as modified continues to qualify for integration. For example, a taxpayer that has issued a floating rate debt instrument that pays interest at a rate referencing USD LIBOR and has entered into an interest rate swap contract that permits that taxpayer to create a synthetic fixed rate debt instrument under the integration rules of §1.1275-6 is not treated as legging out of the integrated transaction if the terms of the debt instrument are altered and the swap is modified to replace the USD LIBOR-referencing interest rate with a SOFR-referencing interest rate, provided that in the transaction as modified the §1.1275-6 hedge continues to meet the requirements for a §1.1275-6 hedge. The proposed regulations provide similar rules for a foreign currency hedge integrated with a debt instrument under §1.988-5(a) and for an interest rate hedge integrated with an issue of tax-exempt bonds under §1.148-4(h). The proposed regulations also provide that, in the case of a transaction subject to the hedge accounting rules under §1.446-4, altering the terms of a debt instrument or modifying the terms of a derivative to replace an IBOR-referencing rate with a qualified rate on one or more legs of the transaction is not a disposition or termination of either leg under §1.446-4(e)(6).

C. Source and Character of a One-Time Payment

Section 1.1001-6(d) of the proposed regulations provides that, for all purposes of the Internal Revenue Code, the source and character of a one-time payment that is made by a payor in connection with an alteration or modification described in proposed §1.1001-6(a)(1), (2), or (3) will be the same as the source and character that would otherwise apply to a payment made by the payor with respect to the debt instrument or non-debt contract that is altered or modified. For example, a one-time payment made by a counterparty to an interest rate swap is treated as a payment with respect to the leg of the swap on which the counterparty making the one-time payment is obligated to perform. Accordingly, under §1.863-7(b), the source of that one-time payment would likely be determined by reference to the residence of the recipient of the payment. With respect to a lease of real property, a one-time payment made by the lessee to the lessor is treated as a payment of rent and, under sections 861(a)(4) and 862(a)(4), the source of that one-time payment would be the location of the leased real property.

The Treasury Department and the IRS expect that parties to debt instruments and non-debt contracts will generally replace the IBOR with an overnight, nearly risk-free rate, such as SOFR. Because of differences in term and credit risk, an overnight, nearly risk-free rate will generally be lower than the IBOR it replaces. Accordingly, the Treasury Department and the IRS expect that, for example, one-time payments with respect to a debt instrument will generally not be paid by the lender to the borrower. However, in the event that it is determined that guidance in respect of such payments is needed, the Treasury Department and the IRS request comments on the source and character of a one-time payment on a debt instrument or non-debt contract received by a party (such as the borrower on a debt instrument or the lessee on a lease) that does not ordinarily receive payments during the term of the debt instrument or non-debt contract.

D. Grandfathered Debt Instruments and Non-Debt Contracts

The rules in §1.1001-6(a) of the proposed regulations generally prevent debt instruments and non-debt contracts from being treated as reissued following a deemed exchange under section 1001. Thus, for example, a debt instrument grandfathered under section 163(f), 871(m), or 1471 or a regulation under one of those sections would not lose its grandfathered status as a result of any alterations made in connection with the elimination of an IBOR and described in §1.1001-6(a)(1) or (3) of the proposed regulations. To provide certainty in treating a non-debt contract as a grandfathered obligation for chapter 4 purposes in the case of the modification of the contract to replace an IBOR-referencing rate, §1.1001-6(e) of the proposed regulations provides that any modification of a non-debt contract to which §1.1001-6(a)(2) or (3) applies is not a material modification for purposes of §1.1471-2(b)(2)(iv).

E. OID and Qualified Floating Rate

Section 1.1275-2(m) of the proposed regulations sets forth three special rules for determining the amount and accrual of OID in the case of a VRDI that provides both for interest at an IBOR-referencing qualified floating rate and for a fallback rate that is triggered when the IBOR becomes unavailable or unreliable. Under §1.1275-2(m)(2), the IBOR-referencing qualified floating rate and the fallback rate are treated as a single qualified floating rate for purposes of §1.1275-5. Under §1.1275-2(m)(3), the possibility that the relevant IBOR will become unavailable or unreliable is treated as a remote contingency for purposes of §1.1275-2(h). Under §1.1275-2(m)(4), the occurrence of the event that triggers activation of the fallback rate is not treated as a change in circumstances. Thus, for example, the VRDI is not treated as retired and reissued under §1.1275-2(h)(6) when the relevant IBOR becomes unavailable or unreliable and the rate changes to the fallback rate, even if the IBOR becoming unavailable or unreliable was a remote contingency at the time the VRDI was issued. With the exception of these three rules in §1.1275-2(m) of the proposed regulations, the OID regulations apply to an IBOR-referencing VRDI as they would to any other debt instrument.

F. REMICs

Section 1.860G-1(e) of the proposed regulations permits an interest in a REMIC to retain its status as a regular interest despite certain alterations and contingencies. Specifically, if the parties to a regular interest alter the terms after the startup day to replace an IBOR-referencing rate with a qualified rate, to include a qualified rate as a fallback to an IBOR-referencing rate, or to make any other alteration described in §1.1001-6(a)(1) or (3) of the proposed regulations, §1.860G-1(e)(2) provides that those alterations are disregarded for the purpose of determining whether the regular interest has fixed terms on the startup day.

Supplementing the list of disregarded contingencies in §1.860G-1(b)(3), §1.860G-1(e)(3) and (4) of the proposed regulations describe certain contingencies affecting the payment of principal and interest that do not prevent an interest in a REMIC from being a regular interest. Under §1.860G-1(e)(3), an interest in a REMIC does not fail to be a regular interest solely because the terms of the interest permit the rate to change from an IBOR-referencing rate to a fallback rate in anticipation of the relevant IBOR becoming unavailable or unreliable. Although this proposed rule permits taxpayers to disregard the contingency in determining whether the rate is a variable rate permitted under §1.860G-1(a)(3), both the IBOR-referencing rate and the fallback rate considered individually must be rates permitted under section 860G. Under §1.860G-1(e)(4) of the proposed regulations, an interest in a REMIC does not fail to be a regular interest solely because the amount of payments of principal or interest may be reduced by reasonable costs of replacing an IBOR-referencing rate with a qualified rate, of amending fallback provisions to address the elimination of an IBOR, or of modifying a non-debt contract that is associated with the interest in the REMIC, such as a credit enhancement. Section 1.860G-1(e)(4) further provides that, if a party other than the REMIC pays those reasonable costs after the startup day, that payment is not subject to the tax imposed under section 860G(d).

G. Interest Expense of a Foreign Corporation

Because the election provided in §1.882-5(d)(5)(ii)(B) only permits a foreign corporation that is a bank to elect a rate that references 30-day LIBOR, the current election will not be available when LIBOR is phased out. To address this change in facts, the proposed regulations amend the election in §1.882-5(d)(5)(ii)(B) to allow a foreign corporation that is a bank to compute interest expense attributable to excess U.S.-connected liabilities using a yearly average SOFR. The Treasury Department and the IRS have determined that SOFR is an appropriate rate to use in §1.882-5(d)(5)(ii)(B) to replace LIBOR. Since SOFR is an overnight rate that does not reflect credit risk, the use of SOFR is likely to result in a lower rate than the 30-day LIBOR calculation previously allowed under §1.882-5(d)(5)(ii)(B). Because of these differences between SOFR and 30-day LIBOR, the Treasury Department and the IRS request comments on whether another nearly risk-free rate might be more appropriate in computing interest expense on excess U.S.-connected liabilities for purposes of §1.882-5(d)(5)(ii)(B).

2. *Proposed Applicability Dates and Reliance on the Proposed Regulations*

A. Proposed Applicability Dates of the Final Regulations

This part 2(A) of the Explanation of Provisions section describes the various applicability dates proposed to apply to the final regulations. Under the proposed applicability date in §1.1001-6(g), §1.1001-6 of the final regulations would apply to an alteration of the terms of a debt instrument or a modification to the terms of a non-debt contract that occurs on or after the date of publication of a Treasury decision adopting those rules as final regulations in the **Federal Register**. However, under proposed §1.1001-6(g), a taxpayer may choose to apply §1.1001-6 of the final regulations to alterations and modifications that occur before that date, provided that the taxpayer and its related parties consistently apply the rules before that date. See section 7805(b)(7).

Under the proposed applicability date in §1.1275-2(m)(5), the OID rules in §1.1275-2(m) of the final regulations would apply to debt instruments issued on or after the date of publication of a Treasury decision adopting those rules as final regulations in the **Federal Register**. However, under proposed §1.1275-2(m)(5), a taxpayer may choose to apply §1.1275-2(m) of the final regulations to debt instruments issued before that date. See section 7805(b)(7).

Under the proposed applicability date in §1.860G-1(e)(5)(i), the REMIC rules in §1.860G-1(e)(2) and (4) of the final regulations would apply with respect to an alteration or modification that occurs on or after the date of publication of a Treasury decision adopting those rules as final regulations in the **Federal Register**. However, a taxpayer may choose to apply §1.860G-1(e)(2) and (4) of the final regulations with respect to an alteration or modification that occurs before that date. See section 7805(b)(7). Under the proposed applicability date in §1.860G-1(e)(5)(ii), §1.860G-1(e)(3) of the final regulations would apply to a regular interest in a REMIC issued on or after the date of publication of a Treasury decision adopting that rule as a final regulation in the **Federal Register**. However, a taxpayer may choose to apply §1.860G-1(e)(3) of the final regulations to a regular interest in a REMIC issued before that date. See section 7805(b)(7).

Under the proposed applicability date in §1.882-5(f)(3), §1.882-5(d)(5)(ii)(B) of the final regulations would apply to taxable years ending after the date of publication of a Treasury decision adopting that rule as a final regulation is published in the **Federal Register**.

B. Reliance on the Proposed Regulations

A taxpayer may rely on the proposed regulations to the extent provided in this part 2(B) of the Explanation of Provisions section. A taxpayer may rely on §1.1001-6 of the proposed regulations for any alteration of the terms of a debt instrument or modification of the terms of a non-debt contract that occurs before the date of publication of a Treasury decision adopting those rules as final regulations in the **Federal Register**, provided that the taxpayer and its related parties consistently apply the rules of §1.1001-6 of the proposed regulations before that date. A taxpayer may rely on §1.1275-2(m) or §1.860G-1(e)(3) of the proposed regulations for any debt instrument or regular interest in a REMIC issued before the date of publication of a Treasury decision adopting those rules as final regulations in the **Federal Register**. A taxpayer may rely on §1.860G-1(e)(2) and (4) of the proposed regulations with respect to any alteration or modification that occurs before the date of publication of a Treasury decision adopting that rule as a final regulation in the **Federal Register**. A taxpayer may rely on §1.882-5(d)(5)(ii)(B) of the proposed regulations for any taxable year ending after October 9, 2019, but before the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

Special Analyses

I. *Regulatory Planning and Review – Economic Analysis*

Executive Orders 12866 and 13563 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including (i) potential economic, environmental, and public health and safety effects, (ii) potential distributive impacts, and (iii) equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

These proposed regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) (MOA) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs has designated these proposed regulations as economically significant under section 1(c) of the MOA.

A. Background, Need for the Proposed Regulations, and Economic Analysis of Proposed Regulations

A very large volume of U.S. financial products and contracts include terms or conditions that reference LIBOR or, more generally, IBORs. Concern about manipulation and a decline in the volume of the funding from which the LIBOR is calculated led to recommendations for the development of alternatives to the LIBOR, ones that would be based on transactions in a more robust underlying market. In addition, on July 27, 2017, the U.K. Financial Conduct Authority, the U.K. regulator tasked with overseeing LIBOR, announced that all currency and term variants of LIBOR, including USD LIBOR, may be phased out after 2021 and not be published after that timeframe. The ARRC, a group of stakeholders affected by the cessation of the publication of USD LIBOR, was convened to identify an alternative rate and to facilitate its voluntary adoption. The ARRC recommended the SOFR as a potential replacement for USD LIBOR. Essentially all financial products and contracts that currently contain conditions or legal provisions that rely on LIBOR and IBORs are expected to transition to the SOFR or similar alternatives in the next few years. This transition will involve changes in debt, derivatives, and other financial contracts to adopt the SOFR or other alternative reference rates.

The ARRC has estimated that the total exposure to USD LIBOR was close to $200 trillion in 2016, of which approximately 95 percent were in over-the-counter derivatives.[1] ARRC further notes that USD LIBOR is also referenced in several trillion dollars of corporate loans, floating-rate mortgages, and similar financial products.

In the absence of further tax guidance, the vast majority of expected changes in such contracts could lead to the recognition of gains (or losses) in these contracts for U.S. income tax purposes and to correspondingly potentially large tax liabilities for their holders. To address this issue, the proposed regulations provide that changes in debt instruments, derivative contracts, and other affected contracts to replace reference rates based on IBORs with qualified rates (as defined in the proposed regulations) will not result in tax realization events under section 1001 and relevant regulations thereunder. The proposed regulations require that qualified rates be substantially equivalent in fair market value to the replaced rates based on any reasonable, consistently applied method of valuation. The proposed regulations further provide certain safe harbors for this comparability standard, based on historic average rates and bona fide fair market value negotiations between unrelated parties. The proposed regulations also provide corresponding guidance on hedging transactions and derivatives to the effect that taxpayers may modify the components of hedged or integrated transactions to replace IBORs with qualified rates without affecting the tax treatment of the hedges or underlying transactions.

In the absence of these proposed regulations, parties to contracts affected by the cessation of the publication of LIBOR would either suffer tax consequences to the extent that a change to the contract results in a tax realization event under section 1001 or attempt to find alternative contracts that avoid such a tax realization event, which may be difficult as a commercial matter. Both such options would be both costly and highly disruptive to U.S. financial markets. A large number of contracts may end up being breached, leading to bankruptcies or other legal proceedings. The types of actions that contract holders might take in the absence of these proposed regulations are difficult to predict because such an event is outside recent experience in U.S. financial markets. This financial disruption would be particularly unproductive because the economic characteristics of the financial products and contracts under the new rates would be essentially unchanged. Thus, there is no underlying economic rationale for a tax realization event.

The Treasury Department and the IRS project that these proposed regulations would avoid this costly and unproductive disruption. The Treasury Department and the IRS further project that these proposed regulations, by implementing the regulatory provisions requested by ARRC and taxpayers, will help facilitate the economy's adaptation to the cessation of the LIBOR in a least-cost manner.

The Treasury Department and the IRS request comments on these proposed regulations.

II. *Regulatory Planning and Review and Regulatory Flexibility Act*

Under the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities that are directly affected by the proposed regulations. These proposed regulations provide rules to minimize the economic impact of the elimination of IBORs on all taxpayers. Parties to IBOR-referencing financial instruments are generally expected to alter or to modify those instruments in response to the elimination of the relevant IBOR and, in the absence of rules such as those proposed, those alterations and modifications may trigger significant tax consequences for the parties to those instruments. In addition, these proposed regulations do not impose a collection of information on any taxpayers, including small entities. Accordingly, this rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

III. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately $150 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

IV. *Executive Order 13132: Federalism*

Executive Order 13132 (titled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by stat-

[1] See Second Report, The Alternative Reference Rates Committee, March 2018, Table 1 and related discussion, available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report.

ute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS specifically seek comment on any complications under any section of the Code or existing regulations that may arise from the replacement of an IBOR with a qualified rate and that are not resolved in these proposed regulations. All comments will be available at *http://www.regulations.gov* or upon request. A public hearing will 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 hearing will be published in the **Federal Register**.

Drafting Information

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

* * * * *

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 is amended by adding an entry in numerical order for §1.1001-6 to read in part as follows:

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

* * * * *

Section 1.1001-6 also issued under 26 U.S.C. 148(i), 26 U.S.C. 988(d), and 26 U.S.C. 1275(d).

* * * * *

Par. 2. Section 1.860A-0 is amended by adding entries for §1.860G-1(e) to read as follows:

§1.860A-0 Outline of REMIC provisions.

* * * * *

§1.860G-1 Definition of regular and residual interests.

* * * * *

(e) Transition from interbank offered rates.

(1) In general.

(2) Change in reference rate for a regular interest after the startup day.

(3) Contingencies of rate on a regular interest.

(4) Reasonable expenses incurred to alter a regular interest.

(5) Applicability dates.

* * * * *

Par. 3. Section 1.860G-1 is amended by adding paragraph (e) to read as follows:

§1.860G-1 Definition of regular and residual interests.

* * * * *

(e) *Transition from interbank offered rates*—(1) *In general*. This paragraph (e) applies to certain interests in a REMIC that provide for a rate referencing an interbank offered rate. See §1.1001-6 for additional rules that may apply to an interest in a REMIC that provides for a rate referencing an interbank offered rate.

(2) *Change in reference rate for a regular interest after the startup day*. An alteration to a regular interest in a REMIC that occurs after the startup day and that is described in §1.1001-6(a)(1) or (3) is disregarded in determining whether the regular interest has fixed terms on the startup day under paragraph (a)(4) of this section.

(3) *Contingencies of rate on a regular interest*. An interest in a REMIC does not fail to qualify as a regular interest solely because it is subject to a contingency whereby a rate that references an interbank offered rate and is a variable rate permitted under paragraph (a)(3) of this section may change to a fixed rate or a different variable rate permitted under paragraph (a)(3) of this section in anticipation of the interbank offered rate becoming unavailable or unreliable.

(4) *Reasonable expenses incurred to alter a regular interest*. An interest in a REMIC does not fail to qualify as a regular interest solely because it is subject to a contingency whereby the amount of payments of principal or interest (or other similar amounts) with respect to the interest in the REMIC is reduced by reasonable costs incurred to effect an alteration or modification described in §1.1001-6(a)(1), (2), or (3). In addition, payment by a party other than the REMIC of reasonable costs incurred to effect an alteration or modification described in §1.1001-6(a)(1), (2), or (3) is not a contribution to the REMIC for purposes of section 860G(d).

(5) *Applicability dates*. (i) Paragraphs (e)(2) and (4) of this section apply with respect to an alteration or modification that occurs on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, taxpayers may apply paragraphs (e)(2) and (4) of this section with respect to an alteration or a modification that occurs before the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. See section 7805(b)(7).

(ii) Paragraph (e)(3) of this section applies to a regular interest in a REMIC issued on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, a taxpayer may apply paragraph (e)(3) of this section to a regular interest in a REMIC issued before the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. See section 7805(b)(7).

Par. 4. Section 1.882-5 is amended by:

1. Revising the fourth sentence of paragraph (a)(7)(i).
2. Revising paragraph (d)(5)(ii)(B).
3. Removing the "(1)" from the "(f)(1)" paragraph designation and adding a subject heading to paragraph (f)(1).
4. Adding paragraph (f)(3).

The revisions and addition read as follows:

§1.882-5 Determination of interest deduction.

(a) * * *

(7) * * *

(i) * * * An elected method (other than the fair market value method under paragraph (b)(2)(ii) of this section, or the published rate election in paragraph (d)(5)(ii) of this section) must be used for a minimum period of five years before the taxpayer may elect a different method. * * *

* * * * *

(d) * * *

(5) * * *

(ii) * * *

(B) *Published rate election*. For each taxable year in which a taxpayer is a bank within the meaning of section 585(a)(2)(B) (without regard to the second sentence thereof or whether any activities are effectively connected with a trade or business within the United States), the taxpayer may elect to compute the interest expense attributable to excess U.S.-connected liabilities by using the yearly average Secured Overnight Financing Rate (SOFR) published by the Federal Bank of New York for the taxable year rather than the interest rate provided in paragraph (d)(5)(ii)(A) of this section. A taxpayer may elect to apply the rate provided in paragraph (d)(5)(ii)(A) of this section or in this paragraph (d)(5)(ii)(B) on an annual basis and the taxpayer does not need the consent of the Commissioner to change this election in a subsequent taxable year. If a taxpayer that is eligible to make the published rate election either does not file a timely return or files a calculation with no excess U.S.-connected liabilities and it is later determined by the Director of Field Operations that the taxpayer has excess U.S.-connected liabilities, then the Director of Field Operations, and not the taxpayer, may choose whether to apply the interest rate provided under either paragraph (d)(5)(ii)(A) or (B) of this section to the taxpayer's excess U.S.-connected liabilities in determining interest expense.

* * * * *

(f) * * *—

(1) *General rule*. * * *

* * * * *

(3) *Applicability date for published rate election*. Paragraph (d)(5)(ii)(B) of this section applies to taxable years ending after the date of publication of a Treasury decision adopting these rules as final regulations is published in the **Federal Register**.

Par. 5. Section 1.1001-6 is added to read as follows:

§1.1001-6 Transition from interbank offered rates.

(a) *Treatment under section 1001*—(1) *Debt instruments*. An alteration of the terms of a debt instrument to replace a rate referencing an interbank offered rate (IBOR) with a qualified rate as defined in paragraph (b) of this section (qualified rate) and any associated alteration as defined in paragraph (a)(5) of this section (associated alteration) are not treated as modifications and therefore do not result in an exchange of the debt instrument for purposes of §1.1001-3. For example, if the terms of a debt instrument that pays interest at a rate referencing the U.S.-dollar London Interbank Offered Rate (USD LIBOR) are altered to provide that the instrument pays interest at a qualified rate referencing the Secured Overnight Financing Rate published by the Federal Reserve Bank of New York, that alteration of terms is not treated as a modification and therefore does not result in an exchange for purposes of §1.1001-3.

(2) *Non-debt contracts*. A modification of the terms of a contract other than a debt instrument (a non-debt contract) to replace a rate referencing an IBOR with a qualified rate and any associated modification as defined in paragraph (a)(5) of this section (associated modification) are not treated as the exchange of property for other property differing materially in kind or extent for purposes of §1.1001-1(a). A non-debt contract includes but is not limited to a derivative, stock, an insurance contract, and a lease agreement.

(3) *Fallback rate*. An alteration of the terms of a debt instrument to include a qualified rate as a fallback to a rate referencing an IBOR and any associated alteration are not treated as modifications and therefore do not result in an exchange of the debt instrument for purposes of §1.1001-3. In addition, an alteration of the terms of a debt instrument to substitute a qualified rate in place of a rate referencing an IBOR as a fallback to another rate and any associated alteration are not treated as modifications and therefore do not result in an exchange of the debt instrument for purposes of §1.1001-3. A modification of the terms of a non-debt contract to include a qualified rate as a fallback to a rate referencing an IBOR and any associated modification are not treated as the exchange of property for other property differing materially in kind or extent for purposes of §1.1001-1(a). In addition, a modification of the terms of a non-debt contract to substitute a qualified rate in place of a rate referencing an IBOR as a fallback to another rate and any associated modification are not treated as the exchange of property for other property differing materially in kind or extent for purposes of §1.1001-1(a).

(4) *Other contemporaneous alterations and modifications*. Whether an alteration of the terms of a debt instrument that is not described in paragraph (a)(1) or (3) of this section and that is made contemporaneously with an alteration described in paragraph (a)(1) or (3) of this section results in an exchange of the debt instrument is determined under §1.1001-3. Similarly, whether a modification of the terms of a non-debt contract that is not described in paragraph (a)(2) or (3) of this section and that is made contemporaneously with a modification described in paragraph (a)(2) or (3) of this section results in an exchange of property for other property differing materially in kind or extent is determined under §1.1001-1(a). In applying §1.1001-3 or §1.1001-1(a) for this purpose, the altered or modified terms described in paragraph (a)(1), (2), or (3) of this section are treated as part of the terms of the debt instrument or non-debt contract prior to any alteration or modification that is not so described. For example, if the parties to a debt instrument change the interest rate from a rate referencing USD LIBOR to a qualified rate and at the same time increase the interest rate to account for deterioration of the issuer's credit since the issue date, the qualified rate is treated as a term of the instrument prior to the alteration and only the addition of the risk premium is analyzed under §1.1001-3.

(5) *Associated alteration or modification*. For purposes of this section, *as-*

sociated alteration or *associated modification* means any alteration of a debt instrument or modification of a non-debt contract that is associated with the alteration or modification by which a qualified rate replaces, or is included as a fallback to, the IBOR-referencing rate and that is reasonably necessary to adopt or to implement that replacement or inclusion. An associated alteration or associated modification may be a technical, administrative, or operational alteration or modification, such as a change to the definition of interest period or a change to the timing and frequency of determining rates and making payments of interest (for example, delaying payment dates on a debt instrument by two days to allow sufficient time to compute and pay interest at a qualified rate computed in arrears). An associated alteration or associated modification may also be the addition of an obligation for one party to make a one-time payment in connection with the replacement of the IBOR-referencing rate with a qualified rate to offset the change in value of the debt instrument or non-debt contract that results from that replacement (a one-time payment).

(b) *Qualified rate*—(1) *In general*. For purposes of this section, a *qualified rate* is any one of the following rates, provided that the rate satisfies the fair market value requirement of paragraph (b)(2) of this section and the currency requirement of paragraph (b)(3) of this section:

(i) The Secured Overnight Financing Rate published by the Federal Reserve Bank of New York (SOFR);

(ii) The Sterling Overnight Index Average (SONIA);

(iii) The Tokyo Overnight Average Rate (TONAR or TONA);

(iv) The Swiss Average Rate Overnight (SARON);

(v) The Canadian Overnight Repo Rate Average (CORRA);

(vi) The Hong Kong Dollar Overnight Index (HONIA);

(vii) The interbank overnight cash rate administered by the Reserve Bank of Australia (RBA Cash Rate);

(viii) The euro short-term rate administered by the European Central Bank (€STR);

(ix) Any alternative, substitute or successor rate selected, endorsed or recommended by the central bank, reserve bank, monetary authority or similar institution (including any committee or working group thereof) as a replacement for an IBOR or its local currency equivalent in that jurisdiction;

(x) Any qualified floating rate, as defined in §1.1275-5(b) (but without regard to the limitations on multiples set forth in §1.1275-5(b)), that is not described in paragraphs (b)(1)(i) through (ix) of this section;

(xi) Any rate that is determined by reference to a rate described in paragraphs (b)(1)(i) through (x) of this section, including a rate determined by adding or subtracting a specified number of basis points to or from the rate or by multiplying the rate by a specified number; or

(xii) Any rate identified as a qualified rate in guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(a) of this chapter) for purposes of this section.

(2) *Substantial equivalence of fair market value*—(i) *In general*. Notwithstanding paragraph (b)(1) of this section, a rate is a qualified rate only if the fair market value of the debt instrument or non-debt contract after the alteration or modification described in paragraph (a)(1), (2), or (3) of this section is substantially equivalent to the fair market value of the debt instrument or non-debt contract before the alteration or modification. In determining fair market value for this purpose, the parties may use any reasonable, consistently applied valuation method and must take into account the value of any one-time payment that is made in connection with the alteration or modification. A reasonable valuation method may (but need not) be based in whole or in part on past or projected values of the relevant rate. The requirements of this paragraph (b)(2)(i) are deemed to be satisfied if the rate meets the safe harbor set forth in paragraph (b)(2)(ii)(A) of this section or if the parties satisfy the safe harbor set forth in paragraph (b)(2)(ii)(B) of this section.

(ii) *Safe harbors*—(A) *Historic average of rates*. Paragraph (b)(2)(i) of this section is satisfied if, on the date of the alteration or modification described in paragraph (a)(1), (2), or (3) of this section, the historic average of the relevant IBOR-referencing rate does not differ by more than 25 basis points from the historic average of the replacement rate, taking into account any spread or other adjustment to the rate, and adjusted to take into account the value of any one-time payment that is made in connection with the alteration or modification. For this purpose, an historic average may be determined by using an industry-wide standard, such as a method of determining an historic average recommended by the International Swaps and Derivatives Association for the purpose of computing the spread adjustment on a rate included as a fallback to an IBOR-referencing rate on a derivative or a method of determining an historic average recommended by the Alternative Reference Rates Committee (or a comparable non-U.S. organization or non-U.S. regulator) for the purpose of computing the spread adjustment for a rate that replaces an IBOR-referencing rate on a debt instrument. An historic average may also be determined by any reasonable method that takes into account every instance of the relevant rate published during a continuous period beginning no earlier than 10 years before the alteration or modification and ending no earlier than three months before the alteration or modification. For purposes of this safe harbor, the historic average must be determined for both rates using the same method and historical data from the same timeframes and must be determined in good faith by the parties with the goal of making the fair market value of the debt instrument or non-debt contract after the alteration or modification substantially equivalent to the fair market value of the debt instrument or non-debt contract before the alteration or modification.

(B) *Arm's length negotiations*. Paragraph (b)(2)(i) of this section is satisfied if the parties to the debt instrument or non-debt contract are not related (within the meaning of section 267(b) or section 707(b)(1)) and the parties determine, based on bona fide, arm's length negotiations between the parties, that the fair market value of the debt instrument or non-debt contract before the alteration or modification described in paragraph (a)(1), (2), or (3) of this section is substantially equivalent to the fair market value after the alteration or modification. For this purpose, the fair market value of the debt instrument or non-debt contract after the alteration or modification must take into account the value of any one-time payment that is made in connection with the alteration or modification.

(C) *Published in the Internal Revenue Bulletin*. In guidance published in the Internal Revenue Bulletin, the Commissioner may set forth additional circumstances in which a rate is treated as satisfying the requirement of paragraph (b)(2)(i) of this section (see §601.601(d)(2)(ii)(a) of this chapter).

(3) *Currency of the interest rate benchmark*. Notwithstanding paragraph (b)(1) of this section, a rate is a qualified rate only if the interest rate benchmark to which the rate refers after the alteration or modification described in paragraph (a)(1), (2), or (3) of this section and the IBOR to which the debt instrument or non-debt contract referred before that alteration or modification are based on transactions conducted in the same currency or are otherwise reasonably expected to measure contemporaneous variations in the cost of newly borrowed funds in the same currency.

(c) *Effect of an alteration of the terms of a debt instrument or a modification of the terms of a derivative on integrated transactions and hedges*. An alteration of the terms of a debt instrument or a modification of the terms of a derivative to replace a rate referencing an IBOR with a qualified rate on one or more legs of a transaction that is integrated under §1.988-5 or §1.1275-6 is not treated as legging-out of the transaction, provided that the §1.1275-6 hedge (as defined in §1.1275-6(b)(2)) or the §1.988-5(a) hedge (as defined in §1.988-5(a)(4)) as modified continues to meet the requirements for a §1.1275-6 hedge or §1.988-5(a) hedge, whichever is applicable. Similarly, an alteration of the terms of a debt instrument or a modification of the terms of a derivative to replace an interest rate referencing an IBOR with a qualified rate on one or more legs of a transaction that is subject to the hedge accounting rules described in §1.446-4 will not be treated as a disposition or termination (within the meaning of §1.446-4(e)(6)) of either leg of the transaction. In addition, a modification to replace an interest rate referencing an IBOR with a qualified rate on a hedging transaction for bonds that is integrated as a qualified hedge under §1.148-4(h) for purposes of the arbitrage investment restrictions applicable to State and local tax-exempt bonds and other tax-advantaged bonds (as defined in §1.150-1(b)) is not treated as a termination of that qualified hedge under §1.148-4(h)(3)(iv)(B), provided that the hedge as modified continues to meet the requirements for a qualified hedge under §1.148-4(h), as determined by applying the special rules for certain modifications of qualified hedges under §1.148-4(h)(3)(iv)(C).

(d) *Source and character of a one-time payment*. For all purposes of the Internal Revenue Code, the source and character of a one-time payment that is made by a payor in connection with the alteration or modification described in paragraph (a)(1), (2), or (3) of this section is the same as the source and character that would otherwise apply to a payment made by the payor with respect to the debt instrument or non-debt contract that is altered or modified.

(e) *Coordination with provision for grandfathered obligations under chapter 4*. A non-debt contract that is modified only as described in paragraph (a)(2) or (3) of this section is not materially modified for purposes of §1.1471-2(b)(2)(iv).

(f) *Coordination with the OID and REMIC rules*. For rules regarding original issue discount on certain debt instruments that provide for a rate referencing an IBOR, see §1.1275-2(m). For rules regarding certain interests in a REMIC that provide for a rate referencing an IBOR, see §1.860G-1(e).

(g) *Applicability date*. This section applies to an alteration of the terms of a debt instrument or a modification of the terms of a non-debt contract that occurs on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Taxpayers and their related parties, within the meaning of sections 267(b) and 707(b)(1), may apply this section to an alteration of the terms of a debt instrument or a modification of the terms of a non-debt contract that occurs before the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**, provided that the taxpayers and their related parties consistently apply the rules of this section before that date. See section 7805(b)(7).

Par. 6. Section 1.1271-0 is amended by adding a reserved entry for §1.1275-2(l) and by adding entries for §1.1275-2(m) to read as follows:

§1.1271-0 Original issue discount; effective date; table of contents.

* * * * *

§1.1275-2 Special rules relating to debt instruments.

* * * * *

(l) [Reserved]

(m) Transition from interbank offered rates.

(1) In general.

(2) Single qualified floating rate.

(3) Remote contingency.

(4) Change in circumstances.

(5) Applicability date.

* * * * *

Par. 7. Section 1.1275-2, as proposed to be amended at 84 FR 47210, September 9, 2019, is further amended by adding paragraph (m) to read as follows:

§1.1275-2 Special rules relating to debt instruments.

* * * * *

(m) *Transition from interbank offered rates*—(1) *In general*. This paragraph (m) applies to a variable rate debt instrument (as defined in §1.1275-5(a)) that provides both for a qualified floating rate that references an interbank offered rate (IBOR) and for a methodology to change the IBOR-referencing rate to a different rate in anticipation of the IBOR becoming unavailable or unreliable. See §1.1001-6 for additional rules that may apply to a debt instrument that provides for a rate referencing an IBOR.

(2) *Single qualified floating rate*. If a debt instrument is described in paragraph (m)(1) of this section, the IBOR-referencing rate and the different rate are treated as a single qualified floating rate for purposes of §1.1275-5.

(3) *Remote contingency*. If a debt instrument is described in paragraph (m)(1) of this section, the possibility that the IBOR will become unavailable or unreliable is treated as a remote contingency for purposes of paragraph (h) of this section.

(4) *Change in circumstances*. If a debt instrument is described in paragraph (m)

(1) of this section, the fact that the IBOR has become unavailable or unreliable is not treated as a change in circumstances for purposes of paragraph (h)(6) of this section.

(5) *Applicability date*. Paragraph (m) of this section applies to debt instruments issued on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. However, a taxpayer may apply paragraph

(m) of this section to debt instruments issued before the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. See section 7805(b)(7).

Sunita Lough,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 8, 2019, 8:45 a.m., and published in the issue of the Federal Register for October 9, 2019, 84 F.R. 54068)

Contribution Limits Applicable to ABLE Accounts

REG-128246-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations related to the Internal Revenue Code (Code), which allows a State (or its agency or instrumentality) to establish and maintain a tax-advantaged savings program under which contributions may be made to an ABLE account for the purpose of paying for the qualified disability expenses of the designated beneficiary of the account. The affected Code section was amended by the Tax Cuts and Jobs Act, signed into law on December 22, 2017. The Tax Cuts and Jobs Act allows certain designated beneficiaries to contribute a limited amount of compensation income to their own ABLE accounts.

DATES: Comments must be received by January 8, 2020.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-128246-18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal at www.regulations.gov comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-128246-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–128246–18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Julia Parnell, (202) 317-4086; concerning submissions of comments and requests for a public hearing, Regina Johnson at email address fdms.database@irscounsel.treas.gov and (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION: This document contains proposed regulations related to section 529A of the Internal Revenue Code (Code), which allows a State (or its agency or instrumentality) to establish and maintain a tax-advantaged savings program under which contributions may be made to an ABLE account for the purpose of paying for the qualified disability expenses of the designated beneficiary of the account. Section 529A was amended by the Tax Cuts and Jobs Act, Public Law 115-97, 131 Stat. 2054, (2017) (2017 Act), signed into law on December 22, 2017. The 2017 Act allows certain designated beneficiaries to contribute a limited amount of compensation income to their own ABLE accounts.

Background

1. *The ABLE Act*

The Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 (the "ABLE Act") was enacted on December 19, 2014, as part of the Tax Increase Prevention Act of 2014, Public Law 113-295, 128 Stat. 4010, (2014). The ABLE Act added section 529A to the Code. Section 529A allows a State (or its agency or instrumentality) to establish and maintain a tax-advantaged savings program under which contributions may be made to an ABLE account for the purpose of paying for the qualified disability expenses of the designated beneficiary of the account. Section 529A was amended by the 2017 Act.

Prior to its amendment by the 2017 Act, section 529A(b)(2) stated that a program shall not be treated as a qualified ABLE program unless it provides that no contribution will be accepted unless it is in cash, or if the contribution (other than a rollover contribution described in section 529A(c)(1)(C)) would result in aggregate contributions from all contributors in excess of the amount of the section 2503(b) gift tax exclusion for the calendar year in which the designated beneficiary's taxable year begins. Under section 529A(b)(2), rules similar to the rules of section 408(d)(4) apply to permit the return of excess contributions (with any attributable net income) on or before the due date (including extensions) of the designated beneficiary's income tax return. In addition, under section 529A(b)(6), a qualified ABLE program must provide adequate safeguards to ensure that total contributions do not exceed the State's limit for aggregate contributions under its qualified tuition program as described in section 529(b)(6). A qualified tuition program under section 529 is a program established by a State (or its agency or instrumentality) that permits a person to prepay or contribute to a tax-favored savings account for a designated beneficiary's qualified higher education expenses (QHEEs) or a program established by an eligible educational institution that permits a person to prepay a designated beneficiary's QHEEs.

2. *Prior Rulemaking and Statutory Change*

On June 22, 2015, the Treasury Department and the IRS published a Notice of Proposed Rulemaking (REG-102837-15) in the **Federal Register** (80 FR 35602) (the 2015 Proposed Regulations). More than 200 written comments were received in response to the 2015 Proposed Regulations and a public hearing was held on October 14, 2015.[1] In addition to these comments, several commenters asked the Treasury Department and the IRS to issue interim guidance to address three particular issues so that these programs could be established before the issuance of final regulations. In order to prevent a delay in the creation of ABLE programs, the Treasury Department and the IRS issued Notice 2015-81, 2015-49 I.R.B. 784 (Dec. 7, 2015), which describes how the Treasury Department and the IRS intend to revise three particular provisions of the proposed regulations under section 529A when those regulations are finalized.

Since the issuance of the 2015 Proposed Regulations and the Notice, two statutes have been enacted that amended one or more provisions of section 529A. On December 18, 2015, section 303 of the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), was enacted as part of the Consolidated Appropriations Act, Public Law 114-113, 129 Stat. 2242, (2016). The PATH Act amended section 529A(b)(1), effective for taxable years beginning after December 31, 2014, by removing the requirement that a State's qualified ABLE program allow the establishment of an ABLE account only for a designated beneficiary who is a resident of that State or of a contracting State. Due to this amendment, the Treasury Department and the IRS intend to remove references to the residency requirement in the proposed regulations under section 529A when those regulations are finalized. The other statutory change was made in the 2017 Act as described in these proposed regulations.

3. *The 2017 Act*

The 2017 Act amended section 529A(b)(2)(B) to allow an employed designated beneficiary described in new section 529A(b)(7) to contribute, prior to January 1, 2026, an additional amount in excess of the limit in section 529A(b)(2)(B)(i) (the annual gift tax exclusion amount in section 2503(b), formerly set forth in section 529A(b)(2)(B)). This additional permissible contribution is subject to its own limit as described in section 529A(b)(2)(B)(ii). Specifically, this additional contributed amount may not exceed the lesser of (i) the designated beneficiary's compensation as defined by section 219(f)(1) for the taxable year, or (ii) an amount equal to the poverty line for a one-person household for the calendar year preceding the calendar year in which the taxable year begins. The 2017 Act also amended the section 529A(b)(2) flush language to require the designated beneficiary, or a person acting on behalf of the designated beneficiary, to maintain adequate records to ensure, and to be responsible for ensuring, that the requirements of section 529A(b)(2)(B)(ii) are met.

New section 529A(b)(7)(A) identifies a designated beneficiary eligible to make this additional contribution as one who is an employee (including a self-employed individual) with respect to whom there has been no contribution made for the taxable year to: a defined contribution plan meeting the requirements of sections 401(a) or 403(a); an annuity contract described in section 403(b); or an eligible deferred contribution plan under section 457(b). Section 529A(b)(7)(B) defines the term "poverty line" as having the meaning provided in section 673 of the Community Services Block Grant Act (42 U.S.C. 9902).

The 2017 Act also amended section 529 to allow, before January 1, 2026, a limited amount to be rolled over to an ABLE account from the designated beneficiary's own section 529 qualified tuition program (QTP) account or from the QTP account of certain family members. The 2017 Act added section 529(c)(3)(C)(i)(III), which provides that a distribution from a QTP made after December 22, 2017, and before January 1, 2026, is not subject to income tax if, within 60 days of the distribution, it is transferred to an ABLE account of the designated beneficiary or a member of the family of the designated beneficiary. Under section 529(c)(3)(C)(i), the amount of any rollover to an ABLE account is limited to the amount that, when added to all other contributions made to the ABLE account for the taxable year, does not exceed the contribution limit for the ABLE account under section 529A(b)(2)(B)(i), that is, the annual gift tax exclusion amount under section 2503(b). This limited rollover is described in more detail in Notice 2018-58, 2018-33 I.R.B. 305 (Aug. 13, 2018).

4. *Notice 2018-62*

To address the 2017 Act modifications to section 529A, the Treasury Department and the IRS published Notice 2018-62, 2018-34 I.R.B. 316 (Aug. 20, 2018), which announces the intent of the Treasury Department and the IRS to issue proposed regulations to implement these changes, and describes the anticipated rules to implement the statutory changes. No comments were received in response to the Notice. These proposed regulations incorporate, without substantive change, the anticipated rules described in that Notice.

Explanation of Provisions

1. *Additional Contributions*

The 2017 Act amended section 529A(b)(2)(B) to permit an employed or self-employed designated beneficiary described in section 529A(b)(7) to contribute to his or her ABLE account the lesser of the designated beneficiary's compensation for the taxable year or an amount equal to the poverty line for a one-person household for the calendar year preceding the calendar year in which the designated beneficiary's taxable year begins. These proposed regulations confirm that the em-

[1] Comments related to the 2015 Proposed Regulations will be considered prior to finalizing them, which the Treasury Department and the IRS expect to occur in conjunction with the finalization of these proposed regulations.

ployed designated beneficiary, or the person acting on his or her behalf, is solely responsible for ensuring that the requirements in section 529A(b)(2)(B)(ii) are met and for maintaining adequate records for that purpose. In addition, to minimize burdens for the designated beneficiary and the qualified ABLE program, these proposed regulations provide that ABLE programs may allow a designated beneficiary or the person acting on his or her behalf to certify, under penalties of perjury, that he or she is a designated beneficiary described in section 529A(b)(7) and that his or her contributions of compensation do not exceed the limit set forth in section 529A(b)(2)(B)(ii).

2. *Poverty Line*

Section 529A(b)(7)(B) provides that the term poverty line referred to in section 529A(b)(2)(B)(ii) has the same meaning given to that term by section 673 of the Community Services Block Grant Act (42 U.S.C. 9902). These proposed regulations clarify that the poverty line in section 529A(b)(7)(B) is to be determined by using the poverty guidelines updated periodically in the **Federal Register** by the U.S. Department of Health and Human Services under the authority of 42 U.S.C. 9902(2). Those guidelines vary based on locality. Specifically, there are separate guidelines for (1) the contiguous 48 states and the District of Columbia, (2) Alaska, and (3) Hawaii. Because the Treasury Department and the IRS have concluded that the poverty guideline that most closely reflects the employed designated beneficiary's cost of living is the most relevant for determining the contribution limit, these proposed regulations provide that a designated beneficiary's contribution limit is to be determined using the poverty guideline applicable in the state of the designated beneficiary's residence.

3. *Return of Excess Contributions*

Because section 529A(b)(2) provides that rules similar to those set forth in section 408(d)(4) regarding the return of excess contributions to an individual retirement account or annuity apply to ABLE accounts, these proposed regulations provide that a qualified ABLE program must return any contributions of the designated beneficiary's compensation in excess of the limit in section 529A(b)(2)(B)(ii) to the designated beneficiary.

Consistent with section 529A(b)(2), these proposed regulations provide that it will be the sole responsibility of the designated beneficiary (or the person acting on the designated beneficiary's behalf) to identify and request the return of any excess contribution of such compensation income. Such returns of excess compensation contributions must be received by the employed designated beneficiary on or before the due date (including extensions) of the designated beneficiary's income tax return for the year in which the excess compensation contributions were made. A failure to return excess contributions within this time period will result in the imposition on the designated beneficiary of a 6 percent excise tax under section 4973(a)(6) on the amount of excess compensation contributions.

Additionally, in order to minimize administrative burdens for the designated beneficiary and the qualified ABLE program, for purposes of ensuring that the limit on contributions made under section 529A(b)(2)(B)(ii) is not exceeded, the qualified ABLE program may rely on self-certifications, made under penalties of perjury, of the designated beneficiary or the person acting on the designated beneficiary's behalf.

Proposed Effective/Applicability Date

These regulations are proposed to apply to taxable years beginning after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. Until the issuance of final regulations, taxpayers and qualified ABLE programs may rely on these proposed regulations.

Special Analyses

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

Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these proposed regulations will not impact a substantial number of small entities. These regulations primarily affect states and individuals and therefore will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are timely submitted to the IRS as prescribed in this preamble under the **"ADDRESSES"** heading. The Treasury Department and the IRS request comments on all aspects of these proposed rules. All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Statement of Availability of IRS Documents

Notices 2015-81, 2018-58 and 2018-62 are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, D.C. 20402, or by visiting the IRS website at *http://www.irs.gov*.

Drafting Information

The principal author of these regulations is Julia Parnell, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

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 is amended by adding an entry for §1.529A–8 in numerical order to read in part as follows:

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

*****

Section 1.529A–8 also issued under 26 U.S.C. 529A(g).

*****

Par. 2. Section 1.529A-0, as proposed to be added at 80 FR 35602, June 22, 2015, is further amended by adding an entry for §1.529A-8 in numerical order to read as follows:

§1.529A-0 Table of contents.

* * * * *

Par.3. Section 1.529A-1, as proposed to be added at 80 FR 35602, June 22, 2015, is further amended by revising paragraph (b)(3) to read as follows:

§1.529A-1 Exempt status of qualified ABLE program and definitions.

* * * * *

(b) * * *

(3) *Contribution* means any payment directly allocated to an ABLE account for the benefit of the designated beneficiary, including amounts transferred from a qualified tuition program under section 529 after December 22, 2017 and before January 1, 2026.

* * * * *

Par. 4. Section 1.529A-8 is added to read as follows:

§1.529A-8 Additional contributions to ABLE accounts made by an employed designated beneficiary.

(a) *Additional contributions by an employed designated beneficiary*—(1) *In general*. An employed designated beneficiary defined in paragraph (b)(1) of this section may contribute amounts up to the limit specified in paragraph (a)(2) of this section in addition to the annual amount described in section 529A(b)(2)(B)(i).

(2) *Amount of additional permissible contribution*. Any additional contribution made by the designated beneficiary pursuant to this section is limited to the lesser of—

(i) The designated beneficiary's compensation as defined by section 219(f)(1) for the taxable year; or

(ii) An amount equal to the applicable poverty line, as defined in paragraph (b)(2) of this section, for a one-person household for the calendar year preceding the calendar year in which the designated beneficiary's taxable year begins.

(b) *Additional definitions.* In addition to the definitions in §1.529A-1(b), the following definitions also apply for the purposes of this section—

(1) *Employed designated beneficiary* means a designated beneficiary who is an employee (including an employee within the meaning of section 401(c)), with respect to whom no contribution is made for the taxable year to—

(i) A defined contribution plan (within the meaning of section 414(i)) with respect to which the requirements of sections 401(a) or 403(a) are met;

(ii) An annuity contract described in section 403(b); and

(iii) An eligible deferred compensation plan described in section 457(b).

(2) *Applicable poverty line* means the amount provided in the poverty guidelines updated periodically in the **Federal Register** by the U.S. Department of Health and Human Services under the authority of 42 U.S.C. 9902(2) for the State of residence of the employed designated beneficiary. If the designated beneficiary lives in more than one state during the taxable year, the applicable poverty line is the poverty line for the state in which the designated beneficiary resided longer than in any other state during that year.

(3) *Excess compensation contribution* means the amount by which the amount contributed during the taxable year of an employed designated beneficiary to the designated beneficiary's ABLE account exceeds the limit in effect under section 529A(b)(2)(B)(ii) and paragraph (a)(2) of this section for the calendar year in which that taxable year of the employed designated beneficiary begins.

(c) *Example*. The following example illustrates the principles of paragraphs (a)(2) and (b)(2) of this section. In 2019, A, the designated beneficiary of an ABLE account, lives in Hawaii. A's compensation, as defined by section 219(f)(1), for 2019 is $20,000. The poverty line for a one-person household in Hawaii was $13,960 in 2018. Because A's compensation exceeded the applicable poverty line amount, A's additional permissible contribution in 2019 is limited to $13,960, the amount of the 2018 applicable poverty line.

(d) *Responsibility for ensuring contribution limit is met*. (1) The employed designated beneficiary, or the person acting on his or her behalf, is solely responsible for ensuring that the requirements in section 529A(b)(2)(B)(ii) and paragraph (a)(2) of this section are met and for maintaining adequate records for that purpose.

(2) A qualified ABLE program may allow a designated beneficiary (or the person acting on his or her behalf) to certify, under penalties of perjury, and in the

manner specified by the qualified ABLE program that —

(i) The designated beneficiary is an employed designated beneficiary; and

(ii) The designated beneficiary's contributions of compensation are not excess compensation contributions.

(e) *Return of excess compensation contributions*. If an excess compensation contribution is deposited into or allocated to the ABLE account of a designated beneficiary, the qualified ABLE program must return that excess contribution, including all net income attributable to the excess contribution, as determined under the rules set forth in §1.408-11 (treating references to an IRA as references to an ABLE account, and references to returned contributions under section 408(d)(4) as references to excess compensation contributions), to the employed designated beneficiary. The employed designated beneficiary, or the person acting on the employed designated beneficiary's behalf, is responsible for identifying any excess compensation contribution and for requesting the return of the excess compensation contribution. The excess compensation contribution, if requested, must be received by the employed designated beneficiary on or before the due date (including extensions) of the Federal income tax return of the employed designated beneficiary for the taxable year in which the excess compensation contribution is made.

(f) *Applicability date*. The rules of this section apply to taxable years beginning after **[DATE OF PUBLICATION OF FINAL REGULATIONS IN THE FEDERAL REGISTER]**.

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 9, 2019, 8:45 a.m., and published in the issue of the Federal Register for October 10, 2019, 84 F.R. 54529)

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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Washington, DC 20224

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We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page *www.irs.gov*) or write to the Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.