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.

EMPLOYEE PLANS

Notice 2020-37, page 900.
This notice sets forth updates on the corporate bond monthly yield curve, the corresponding spot segment rates for May 2020 used under § 417(e)(3)(D), the 24-month average segment rates applicable for May 2020, and the 30-year Treasury rates, as reflected by the application of § 430(h)(2)(C)(iv).

INCOME TAX

T.D. 9897, page 882.
This document contains final regulations regarding the treatment of certain interests in corporations as stock or indebtedness. The final regulations generally affect corporations, including those that are partners of certain partnerships, when those corporations or partnerships issue purported indebtedness to related corporations or partnerships.

Notice 2020-38, page 903.
This notice provides the inflation adjustment factors and reference prices for calendar year 2020 that are used to determine the availability of the renewable electricity production credit, the refined coal production credit, and the Indian coal production credit under section 45. The notice also provides the credit amounts for calendar year 2020 under section 45.

This revenue procedure updates and supersedes Rev. Proc. 2019-23 by providing an updated list of countries with which the United States has in force an information exchange agreement, such that bank deposit interest paid to residents of such countries must be reported by payors to the extent required under Treas. Reg. §§1.6049-8(a) and 1.6049-4(b)(5). This revenue procedure adds one country, Singapore, to this list.

REG-104591-18, page 911.
The proposed regulations provide guidance under amended section 162(f) of the Internal Revenue Code (Code), concerning the deduction of certain fines, penalties, and other amounts, and guidance concerning the information reporting requirements, under new section 6050X of the Code, with respect to respect to those fines, penalties, and other amounts. The proposed regulations affect taxpayers that pay or incur amounts to, or at the direction of, governments or governmental entities in relation to the violation of a law or investigations or inquiries by governments or governmental entities into the potential violation of a law. The proposed regulations also affect governments or governmental entities subject to the related reporting requirement. In general, the amendments to section 162(f) and new section 6050X apply to amounts paid or incurred on or after December 22, 2017.

TAX CONVENTIONS

Announcement 2020-6, page 911.
This announcement provides the Treasury Department and IRS view on the interpretation of references to the North American Free Trade Agreement (NAFTA) once that agreement is replaced by the Agreement between the United States Canada and Mexico (the USMCA). Once the USMCA goes into force, the Treasury Department and IRS will interpret any references to NAFTA in a U.S. income tax treaty as a reference to the USMCA.

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:

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 1.385-1; 26 CFR 1.385-3; 26 CFR 1.385-4T.D. 9897

T.D. 9897

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1
The Treatment of Certain Interests in Corporations as Stock or Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations regarding the treatment of certain interests in corporations as stock or indebtedness. The final regulations generally affect corporations, including those that are partners of certain partnerships, when those corporations or partnerships issue purported indebtedness to related corporations or partnerships.

DATES: Effective date: These regulations are effective on May 14, 2020.

Applicability dates: For dates of applicability, see §§1.385-3(j)(1) and (k) and 1.385-4(g).

FOR FURTHER INFORMATION CONTACT: Azeka J. Abramoff or D. Peter Merkel of the Office of Associate Chief Counsel (International) at (202) 317-6938 or Jeremy Aron-Dine of the Office of Associate Chief Counsel (Corporate) at (202) 317-6848 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Overview

Section 385 authorizes the Secretary of the Treasury (Secretary) to prescribe rules to determine whether an interest in a corporation is treated as stock or indebtedness (or as in part stock and in part indebtedness). On October 21, 2016, the Treasury Department and the IRS published T.D. 9790 in the Federal Register (81 FR 72885), which included final rules under sections 385 and temporary regulations under section 385 (2016 Final Regulations and Temporary Regulations, respectively, and together, the 2016 Regulations). 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) (2016 Proposed Regulations) by cross-reference to the Temporary Regulations, which included §§1.385-3T and 1.385-4T. Technical corrections to the 2016 Regulations were published in the Federal Register (82 FR 8169) on January 24, 2017.

The 2016 Regulations and the 2016 Proposed Regulations address the classification of certain related-party debt as stock or indebtedness (or as in part stock and in part indebtedness) for U.S. Federal income tax purposes. The 2016 Final Regulations included documentation rules set forth in §1.385-2 (the Documentation Regulations). The 2016 Regulations also included §§1.385-3, 1.385-3T, and 1.385-4T, which treat certain indebtedness as stock that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result (the Distribution Regulations). The Distribution Regulations apply to taxable years ending on or after January 19, 2017.

The Temporary Regulations set forth rules regarding the treatment under the Distribution Regulations of certain qualified short-term debt instruments, transactions involving controlled partnerships, and transactions involving consolidated groups. The Temporary Regulations apply to taxable years ending on or after January 19, 2017. The Temporary Regulations expired 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. The preamble to the 2016 Regulations requested comments on all aspects of the Temporary Regulations, and the preamble to the 2016 Proposed Regulations requested comments on all aspects of the 2016 Proposed Regulations. REG-130314-16, 81 FR 72751, 72858 (October 21, 2016). The preamble to the 2016 Regulations also requested comments on certain aspects of the exception for qualified short-term debt instruments.

On October 28, 2019, the Treasury Department and the IRS issued Notice 2019-58, 2019-44 I.R.B. 1022, which announced that, following the expiration of the Temporary Regulations, a taxpayer may rely on the 2016 Proposed Regulations until further notice is given in the Federal Register, provided that the taxpayer consistently applies the rules in the 2016 Proposed Regulations in their entirety. On November 4, 2019, the Treasury Department and the IRS published an advance notice of proposed rulemaking in the Federal Register (84 FR 59318) (the ANPRM), which announced that the Treasury Department and the IRS intend to propose more streamlined and targeted Distribution Regulations. The ANPRM also obsoleted Notice 2019-58 and announced that a taxpayer may rely on the 2016 Proposed Regulations until further notice is given in the Federal Register, provided that the taxpayer consistently applies the rules in the 2016 Proposed Regulations in their entirety. This Treasury decision finalizes the 2016 Proposed Regulations without any substantive change (the 2020 Final Regulations).

II. Executive Order 13789

Executive Order 13789 (E.O. 13789), issued on April 21, 2017, instructed the Secretary to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate the burdens of regulations that (i) impose an undue financial burden on U.S. taxpayers; (ii) add undue complexity to the Federal tax laws; or (iii) exceed the statutory authority of the IRS. E.O. 13789 further instructed the Secretary to submit to the President within 60 days a report (First Report) that identifies regulations that meet these criteria. The First Report, Notice 2017-38, 2017-30 I.R.B. 147, which...
was published on July 24, 2017, included the 2016 Regulations in a list of eight regulations identified by the Secretary in the First Report as meeting at least one of the first two criteria specified in E.O. 13789.

E.O. 13789 further instructed the Secretary to submit to the President a report (Second Report) that recommended specific actions to mitigate the burden imposed by regulations identified in the First Report. On October 16, 2017, the Secretary published in the Federal Register the Second Report (82 FR 48013), which stated that (i) the Treasury Department and the IRS were considering a proposal to revoke the Documentation Regulations as issued and (ii) the Treasury Department will reassess the distribution regulations in light of impending tax reform, and the Treasury Department and the IRS may then propose more streamlined and targeted regulations. On September 24, 2018, the Treasury Department and the IRS published proposed regulations in the Federal Register that proposed removal of the Documentation Regulations from the Code of Federal Regulations. See 83 FR 48265 (September 24, 2018) (2018 Proposed Regulations). On November 4, 2019, the Treasury Department and the IRS published T.D. 9880 in the Federal Register (84 FR 59297), which finalized without change the proposed regulations removing the Documentation Regulations.

In response to E.O. 13789 and the 2018 Proposed Regulations, several comments recommended that the Treasury Department and the IRS revoke the Distribution Regulations in addition to the Documentation Regulations, while one comment recommended that the Treasury Department and the IRS issue more streamlined and targeted Distribution Regulations. The ANPRM stated that the Treasury Department and the IRS are cognizant that a complete withdrawal of the Distribution Regulations could restore incentives for multinational corporations to generate additional interest deductions without new investment. Accordingly, the Treasury Department and the IRS determined that the Distribution Regulations continue to be necessary at this time. The ANPRM also announced that the Treasury Department and the IRS intend to propose more streamlined and targeted Distribution Regulations.

The 2016 Proposed Regulations cross-reference the Temporary Regulations, a part of the Distribution Regulations, which expired on October 13, 2019. Because of the general determination that the Distribution Regulations continue to be necessary at this time, the Treasury Department and the IRS are issuing the 2020 Final Regulations, which finalize the 2016 Proposed Regulations, while the Treasury Department and the IRS study the appropriate approach to revising the Distribution Regulations, as discussed in the ANPRM.

III. The Distribution Regulations

Under the Distribution Regulations’ general rule, the issuance of a debt instrument by a member of an expanded group to another member of the same expanded group in a distribution, or an economically similar acquisition transaction, may result in the treatment of the debt instrument as stock. See §1.385-3(b)(2). The Distribution Regulations also include a funding rule that treats as stock a debt instrument that is issued as part of a series of transactions that achieves a result similar to a general rule transaction. See §1.385-3(b)(3)(i). Specifically, §1.385-3(b) treats as stock a debt instrument that was issued in exchange for property, including cash, to fund a distribution to an expanded group member or another acquisition transaction that achieves an economically similar result. Id. Furthermore, the Distribution Regulations include a per se rule, which treats a debt instrument as funding a distribution to an expanded group member or another acquisition transaction with a similar economic effect if it was issued in exchange for property during the period beginning 36 months before and ending 36 months after the issuer of the debt instrument made the distribution or undertook an acquisition transaction with a similar economic effect. See §1.385-3(b)(3)(iii). The Distribution Regulations also include several exceptions limiting their scope. See, e.g., §1.385-3(c).

The Distribution Regulations generally apply to transactions among members of an expanded group of corporations, which is generally defined by reference to the term “affiliated group” in section 1504(a), with several modifications, such as including foreign corporations in the expanded group. See §1.385-1(c)(4). The Distribution Regulations also generally apply only to “covered debt instruments” that are issued by “covered members” other than certain regulated financial companies and regulated insurance companies. See §1.385-3(g)(3)(i). A covered member is a member of an expanded group that is a domestic corporation. See §1.385-1(c)(2). A covered debt instrument is generally a debt instrument that is issued after April 4, 2016, other than certain excluded specialized debt instruments. See §1.385-3(g)(3). In addition to these scope limitations, the funding rule also excludes qualified short-term debt instruments, as defined in §1.385-3(b)(3)(vii). See §1.385-3(b)(3)(i).

Summary of Comments

The Treasury Department and the IRS have not received any comments specifically in response to the Temporary Regulations or the 2016 Proposed Regulations. Accordingly, the 2016 Proposed Regulations are adopted as final regulations without any substantive change. In addition, the Temporary Regulations are withdrawn. Comments on the 2016 Regulations that are not specific to the particular matters addressed in the Temporary Regulations or the 2016 Proposed Regulations are beyond the scope of this rulemaking and are not addressed in this preamble.

Pursuant to E.O. 13789 and the ANPRM, the Treasury Department and the IRS intend to issue proposed regulations modifying the Distribution Regulations to make them more streamlined and targeted, including by withdrawing the per se rule. In connection with the intended revisions, the Treasury Department and the IRS continue to study all appropriate modifications to the Distribution Regulations.

Applicability Dates

The amendments to §1.385-3, other than §1.385-3(f)(4)(iii), apply to taxable years ending after January 19, 2017. Sections 1.385-3(f)(4)(iii) and 1.385-4 provide rules applicable to members of consolidated groups and are issued under section 1502. Section 1503(a) provides in general, that in any case in which a consolidated return is made or is required to be made, the tax shall be determined,
computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed before the last day prescribed by law for the filing of such return. Thus, §§1.385-3(f)(4)(iii) and 1.385-4 apply to taxable years for which the U.S. Federal income tax return is due, without extensions, after May 14, 2020.

The Temporary Regulations apply to taxable years ending on or after January 19, 2017, and before their expiration on October 13, 2019. For rules applying §§1.385-3T(f)(4)(iii) and 1.385-4T to taxable years ending on or after January 19, 2017 and for which the U.S. Federal income tax return was due, without extensions, on or before May 14, 2020, see §§1.385-3T and 1.385-4T (as contained in 26 CFR in part 1 revised as of April 1, 2019). The provisions in the Temporary Regulations and the corresponding provisions in the 2020 Final Regulations are substantially identical.

For certain taxable years for which the U.S. Federal income tax return was due, without extensions, on or before May 14, 2020, there may be a period after October 13, 2019, to which neither §§1.385-3T(f)(4)(iii) and 1.385-4T nor §§1.385-3(f)(4)(iii) and 1.385-4 apply. The 2020 Final Regulations allow a taxpayer to choose to apply §§1.385-3(f)(4)(iii), 1.385-4, or both to such period, provided that all members of the expanded group apply that section or sections. Accordingly, a taxpayer may choose to apply the 2020 Final Regulations to the period, if any, to which neither the Temporary Regulations nor the 2020 Final Regulations apply.

Special Analyses

I. Regulatory Planning and Review — Economic Analysis

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

II. Paperwork Reduction Act

These regulations do not establish a new collection of information nor modify an existing collection that requires the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. chapter 35).

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. Chapter 6), it is hereby certified that the 2020 Final Regulations will not have a significant economic impact on a substantial number of small entities.

Section 1.385-3 provides that certain interests in a corporation that are held by a member of the corporation’s expanded group and that otherwise would be treated as indebtedness for Federal tax purposes are treated as stock. The regulations under Section 1.385-3 finalized in the 2020 Final Regulations provide that for certain debt instruments issued by a controlled partnership, the holder is deemed to transfer all or a portion of the debt instrument to the partner or partners in the partnership in exchange for stock in the partner or partners. Section 1.385-4 provides rules regarding the application of §1.385-3 to members of a consolidated group. Section 1.385-3 includes multiple exceptions that limit its application. In particular, the threshold exception provides that the first $50 million of expanded group debt instruments that otherwise would be reclassified as stock or deemed to be transferred to a partner in a controlled partnership under §1.385-3 will not be reclassified or deemed transferred under §1.385-3. Although it is possible that the classification rules in the 2020 Final Regulations could have an effect on small entities, the threshold exception of the first $50 million of debt instruments otherwise subject to recharacterization or deemed transfer under §§1.385-3 and 1.385-4 makes it unlikely that a substantial number of small entities will be affected by these provisions.

Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. No comments were received concerning the economic impact on small entities from the Small Business Administration.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. 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.

V. Executive Order 13132: Federalism

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

Statement of Availability of IRS Documents


Drafting Information

The principal authors of these final regulations are Azeka J. Abramoff and D. Peter Merkel of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.
List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.385-3T and 1.385-4T and adding an entry for §1.385-4 in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 

Section 1.385-4 also issued under 26 U.S.C. 385 and 1502.

** §1.385-1 [Amended] **

Par. 2. Section 1.385-1 is amended by:

1. In paragraph (c)(4)(vii), designating Examples 1 through 4 as paragraphs (c)(4)(vii)(A) through (D), respectively.

2. In newly designated paragraphs (c)(4)(vii)(A) through (D), redesignating the paragraphs in the first column as the paragraphs in the second column:

<table>
<thead>
<tr>
<th>Old paragraphs</th>
<th>New paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(c)(4)(vii)(A)(i) and (ii)</td>
<td>(c)(4)(vii)(A)(I) and (2)</td>
</tr>
<tr>
<td>(c)(4)(vii)(B)(i) and (ii)</td>
<td>(c)(4)(vii)(B)(I) and (2)</td>
</tr>
<tr>
<td>(c)(4)(vii)(C)(i) and (ii)</td>
<td>(c)(4)(vii)(C)(I) and (2)</td>
</tr>
<tr>
<td>(c)(4)(vii)(D)(i) and (ii)</td>
<td>(c)(4)(vii)(D)(I) and (2)</td>
</tr>
</tbody>
</table>

3. Revise the last sentence of newly re-designated paragraph (c)(4)(vii)(B)(I).

4. In newly designated paragraphs (c)(4)(vii)(C)(2) and (c)(4)(vii)(D)(2), redesignating the paragraphs in the first column as the paragraphs in the second column:

<table>
<thead>
<tr>
<th>Old paragraphs</th>
<th>New paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(c)(4)(vii)(C)(2) and (B)</td>
<td>(c)(4)(vii)(C)(2)(i) and (ii)</td>
</tr>
<tr>
<td>(c)(4)(vii)(D)(2) and (C)</td>
<td>(c)(4)(vii)(D)(2)(i) through (iii)</td>
</tr>
</tbody>
</table>

5. For each paragraph listed in the table, remove the language in the “Remove” column wherever it appears and add in its place the language in the “Add” column as set forth below:

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Remove</th>
<th>Add</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>1.385-4T</td>
<td>1.385-4</td>
</tr>
<tr>
<td>(c) introductory text</td>
<td>1.385-4T(e)</td>
<td>1.385-4(e)</td>
</tr>
<tr>
<td>(c)(4)(i) introductory text</td>
<td>corporations described in section 1504(b)(8)</td>
<td>S corporations</td>
</tr>
<tr>
<td>(c)(4)(i) introductory text</td>
<td>not described in section 1504(b)(6) or (b)(8) (an expanded group parent)</td>
<td>that is not an S corporation or a regulated investment company or a real estate investment trust subject to tax under subchapter M of chapter 1 of the Internal Revenue Code (a RIC or a REIT, respectively) (such common parent corporation, an expanded group parent)</td>
</tr>
<tr>
<td>(c)(4)(vii) introductory text</td>
<td>described in section 1504(b)(6) or (b)(8)</td>
<td>an S corporation, a RIC, or a REIT</td>
</tr>
<tr>
<td>(c)(4)(vii)(B)(2)</td>
<td>P is a real estate investment trust described in section 1504(b)(6)</td>
<td>P is a REIT</td>
</tr>
<tr>
<td>(c)(4)(vii)(B)(2)</td>
<td>Although S2 is a corporation described in section 1504(b)(6), a corporation described in section 1504(b)(6) may</td>
<td>Although S2 is a corporation that is a REIT, a REIT may</td>
</tr>
<tr>
<td>(c)(4)(vii)(D)(I)</td>
<td>Example 3</td>
<td>paragraph (c)(4)(vii)(C)(I) of this section (Example 3)</td>
</tr>
<tr>
<td>(d)(1)(iv)(A)</td>
<td>1.385-3T(d)(4)</td>
<td>1.385-3(d)(4)</td>
</tr>
<tr>
<td>(d)(1)(iv)(B)</td>
<td>1.385-3T(f)(4)</td>
<td>1.385-3(f)(4)</td>
</tr>
</tbody>
</table>

The revision reads as follows:

** §1.385-1 General provisions. **

** (B) ** ** (I) ** Both P and S2 are REITs. ** **

Par. 3. Section 1.385-3 is amended by:

1. Revising the section heading.

2. For each paragraph listed in the table, remove the language in the “Remove” column wherever it appears and add in its place the language in the “Add” column as set forth below:
3. Revising paragraphs (b)(3)(vii), (d)(4), (f), and (g)(5) through (8), (15) through (17), (22), and (23).

4. In paragraph (h)(3), designating Examples 1 through 19 as paragraphs (h)(3)(i) through (xix), respectively.

5. In newly designated paragraphs (h)(3)(i) through (xi), redesignating the paragraphs in the first column as the paragraphs in the second column:


7. For each newly designated paragraph listed in the table, remove the language in the “Remove” column wherever it appears and add in its place the language in the “Add” column as set forth below:

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Remove</th>
<th>Add</th>
</tr>
</thead>
<tbody>
<tr>
<td>(h)(3)(v)(A)</td>
<td>Example 4 of this paragraph (h)(3)</td>
<td>paragraph (h)(3)(iv)(A) of this section (Example 4)</td>
</tr>
<tr>
<td>(h)(3)(v)(B)</td>
<td>Example 4 of this paragraph (h)(3)</td>
<td>paragraph (h)(3)(iv)(B) of this section (Example 4)</td>
</tr>
<tr>
<td>(h)(3)(vi)(A)</td>
<td>Example 6 of this paragraph (h)(3)</td>
<td>paragraph (h)(3)(vi)(A) of this section (Example 6)</td>
</tr>
</tbody>
</table>
8. Revising newly designated paragraphs (h)(3)(xii) through (xix) and paragraph (j)(1).

9. Adding paragraphs (j)(3) and (k).

The revisions and additions read as follows:

§1.385-3 Certain distributions of debt instruments and similar transactions.

(b) ** *

(3) ** *

(vii) Qualified short-term debt instrument. The term qualified short-term debt instrument means a covered debt instrument that is described in paragraphs (b)(3)(vii)(A) through (D) of this section.

(A) Short-term funding arrangement. A covered debt instrument is described in this paragraph (b)(3)(vii)(A) if the requirements of the specified current assets test described in paragraph (b)(3)(vii)(A)(1) of this section or the 270-day test described in paragraph (b)(3)(vii)(A)(2) of this section (the alternative tests) are satisfied, provided that an issuer may only claim the benefit of one of the alternative tests with respect to covered debt instruments issued by the issuer in the same taxable year.

(i) Specified current assets test—(i) In general. The requirements of this paragraph (b)(3)(vii)(A)(1) are satisfied with respect to a covered debt instrument if the requirement of paragraph (b)(3)(vii)(A)(1)(ii) of this section is satisfied, but only to the extent of the requirements of paragraph (b)(3)(vii)(A)(1)(iii) of this section is satisfied.

(ii) Maximum interest rate. The rate of interest charged with respect to the covered debt instrument does not exceed an arm’s length interest rate, as determined under section 482 and §§ 1.482-1 through 1.482-9, that would be charged with respect to a comparable debt instrument of the issuer with a term that does not exceed 270 days.

(iii) Maximum outstanding balance. The amount owed by the issuer under covered debt instruments issued to members of the issuer’s expanded group that satisfy the requirements of paragraph (b)(3)(vii)(A)(1)(ii), (b)(3)(vii)(A)(2)(ii) (if the covered debt instrument was issued in a prior taxable year), or (b)(3)(vii)(B) or (C) of this section immediately after the covered debt instrument is issued does not exceed the maximum of the amounts of specified current assets reasonably expected to be reflected, under applicable accounting principles, on the issuer’s balance sheet as a result of transactions in the ordinary course of business during the subsequent 90–day period or the issuer’s normal operating cycle, whichever is longer. For purposes of the preceding sentence, in the case of an issuer that is a qualified cash pool header, the amount owed by the issuer shall not take into account deposits described in paragraph (b)(3)(vii)(D) of this section. Additionally, the amount owed by any issuer shall be reduced by the amount of the issuer’s deposits with a qualified cash pool header, but only to the extent of amounts borrowed from the same qualified cash pool header that satisfy the requirements of paragraph (b)(3)(vii)(A)(2) (if the covered debt instrument was issued in a prior taxable year) or (b)(3)(vii)(A)(1)(ii) of this section.

(iv) Specified current assets. For purposes of paragraph (b)(3)(vii)(A)(1)(iii) of this section, the term specified current assets means assets that are reasonably expected to be realized in cash or sold (including by being incorporated into inventory that is sold) during the normal operating cycle of the issuer, other than cash, cash equivalents, and assets that are reflected on the books and records of a qualified cash pool header.

(v) Normal operating cycle. For purposes of paragraph (b)(3)(vii)(A)(1) of this section, the term normal operating cycle means the issuer’s normal operating cycle as determined under applicable accounting principles, except that if the issuer has no single clearly defined normal operating cycle, then the normal operating cycle is determined based on a reasonable analysis of the length of the operating cycles of the multiple businesses and their sizes relative to the overall size of the issuer.

(vi) Applicable accounting principles. For purposes of paragraph (b)(3)(vii)(A)(1) of this section, the term applicable accounting principles means the financial accounting principles generally accepted in the United States, or an international financial accounting standard, that is applicable to the issuer in preparing its financial statements, computed on a consistent basis.

(2) 270-day test—(i) In general. A covered debt instrument is described in this paragraph (b)(3)(vii)(A)(2) if the requirements of paragraphs (b)(3)(vii)(A)(2)(ii) through (iv) of this section are satisfied.

(ii) Maximum term and interest rate. The covered debt instrument must have a term of 270 days or less or be an advance under a revolving credit agreement or similar arrangement and must bear a rate of interest that does not exceed an arm’s length interest rate, as determined under section 482 and §§ 1.482-1 through 1.482-9, that would be charged with respect to a comparable debt instrument of the issuer with a term that does not exceed 270 days.

(iii) Lender-specific indebtedness limit. The issuer is a net borrower from the lender for no more than 270 days during the taxable year of the issuer, and in the case of a covered debt instrument outstanding during consecutive tax years, the issuer is a net borrower from the lender for no more than 270 consecutive days, in both cases taking into account only covered debt instruments that satisfy the requirements of paragraph (b)(3)(vii)(A)(2)(ii) of this section other than covered debt instruments described in paragraph (b)(3)(vii)(B) or (C) of this section.

(iv) Overall indebtedness limit. The issuer is a net borrower under all covered debt instruments issued to members of the issuer’s expanded group that satisfy the requirements of paragraphs (b)(3)(vii)(A)(2)(ii) and (iii) of this section, other than covered debt instruments described in paragraph (b)(3)(vii)(B) or (C) of this section, for no more than 270 days during the taxable year of the issuer, determined without regard to the identity of the lender under such covered debt instruments.

(v) Inadvertent error. An issuer’s failure to satisfy the 270-day test will be disregarded if the failure is reasonable in light of all the facts and circumstances and the failure is promptly cured upon discovery. A failure to satisfy the 270-day test will be considered reasonable if the taxpayer maintains due diligence procedures to prevent such failures, as evidenced by having written policies and operational procedures in place to monitor compliance with the 270-day test and management-level employees of the expanded group having undertaken reasonable efforts to establish, follow, and enforce such policies and procedures.
(B) Ordinary course loans. A covered debt instrument is described in this paragraph (b)(3)(vii)(B) if the covered debt instrument is issued for consideration for the acquisition of property other than money in the ordinary course of the issuer’s trade or business, provided that the obligation is reasonably expected to be repaid within 120 days of issuance.

(C) Interest-free loans. A covered debt instrument is described in this paragraph (b)(3)(vii)(C) if the instrument does not provide for stated interest or no interest is charged on the instrument, the instrument does not have original issue discount (as defined in section 1273-1 and 1.1273-2), interest is imputed under section 483 or section 7872 and §§ 1.483-1 through 1.483-4 or §§ 1.7872-1 through 1.7872-16, respectively, and interest is not required to be charged under section 482 and §§ 1.482-1 through 1.482-9.

(D) Deposits with a qualified cash pool header—(1) In general. A covered debt instrument is described in this paragraph (b)(3)(vii)(D) if it is a demand deposit received by a qualified cash pool header described in paragraph (b)(3)(vii)(D)(2) of this section pursuant to a cash-management arrangement described in paragraph (b)(3)(vii)(D)(3) of this section. This paragraph (b)(3)(vii)(D) does not apply if a purpose for making the demand deposit is to facilitate the avoidance of the purposes of this section with respect to a qualified business unit (as defined in section 989(a) and §1.989(a)-1 (QBU) that is not a qualified cash pool header.

(2) Qualified cash pool header. The term qualified cash pool header means an expanded group member, controlled partnership, or QBU described in §1.989(a)-1(b)(2)(ii), that has as its principal purpose managing a cash-management arrangement for participating expanded group members, provided that the excess (if any) of funds on deposit with such expanded group member, controlled partnership, or QBU (header) over the outstanding balance of loans made by the header is maintained on the books and records of the header in the form of cash or cash equivalents, or invested through deposits with, or the acquisition of obligations or portfolio securities of, persons that do not have a relationship to the header (or, in the case of a header that is a QBU described in §1.989(a)-1(b)(2)(ii), its owner) described in section 267(b) or section 707(b).

(3) Cash-management arrangement. The term cash-management arrangement means an arrangement the principal purpose of which is to manage cash for participating expanded group members. For purposes of the preceding sentence, managing cash means borrowing excess funds from participating expanded group members and lending funds to participating expanded group members, and may also include foreign exchange management, clearing payments, investing excess cash with an unrelated person, depositing excess cash with another qualified cash pool header, and settling intercompany accounts, for example through netting centers and pay-on-behalf-of programs.

(4) Treatment of disregarded entities. This paragraph (d)(4) applies to the extent that a covered debt instrument issued by a disregarded entity, the regarded owner of which is a covered member, would, absent the application of this paragraph (d)(4), be treated as stock under this section. In this case, rather than the covered debt instrument being treated as stock to such extent (applicable portion), the covered member that is the regarded owner of the disregarded entity is deemed to issue its stock in the manner described in this paragraph (d)(4). If the applicable portion otherwise would have been treated as stock under paragraph (b)(2) of this section, then the covered member is deemed to issue its stock to the expanded group member to which the covered debt instrument was, in form, issued (or transferred) in the transaction described in paragraph (b)(2) of this section. If the applicable portion otherwise would have been treated as stock under paragraph (b)(3)(i) of this section, then the covered member is deemed to issue its stock to the holder of the applicable portion of the debt instrument issued by the disregarded entity, and the actual holder is treated as the holder of the remaining portion of the covered debt instrument and the stock deemed to be issued by the regarded owner. Under Federal tax principles, the applicable portion of the debt instrument issued by the disregarded entity generally is disregarded. This paragraph (d)(4) must be applied in a manner that is consistent with the principles of paragraph (f)(4) of this section. Thus, for example, stock deemed issued is deemed to have the same terms as the covered debt instrument issued by the disregarded entity, other than the identity of the issuer, and payments on the stock are determined by reference to payments made on the covered debt instrument issued by the disregarded entity. See §1.385-4(b)(3) for additional rules that apply if the regarded owner of the disregarded entity is a member of a consolidated group. If the regarded owner of a disregarded entity is a controlled partnership, then paragraph (f) of this section applies as though the controlled partnership were the issuer in form of the debt instrument.

(f) Treatment of controlled partnerships—(1) In general. For purposes of this section and §1.385-4, a controlled partnership is treated as an aggregate of its partners in the manner described in this paragraph (f). Paragraph (f)(2) of this section sets forth rules concerning the aggregate treatment when a controlled partnership acquires property from a member of the expanded group. Paragraph (f)(3) of this section sets forth rules concerning the aggregate treatment when a controlled partnership issues a debt instrument. Paragraph (f)(4) of this section deems a debt instrument issued by a controlled partnership to be held by an expanded group partner rather than the holder-in-form in certain cases. Paragraph (f)(5) of this section sets forth the rules concerning events that cause the deemed results described in paragraph (f)(4) of this section to cease. Paragraph (f)(6) of this section exempts certain issuances of a controlled partnership’s debt to a partner and a partner’s debt to a controlled partnership from the application of this section. For definitions applicable for this section, see paragraph (g) of this section. For examples illustrating the application of this section, see paragraph (h) of this section.

(2) Acquisitions of property by a controlled partnership—(i) Acquisitions of
property when a member of the expanded group is a partner on the date of the acquisition—(A) Aggregate treatment. Except as otherwise provided in paragraphs (f)(2)(i)(C) and (f)(6) of this section, if a controlled partnership, with respect to an expanded group, acquires property from a member of the expanded group (transferor member), then, for purposes of this section, a member of the expanded group that is an expanded group partner on the date of the acquisition is treated as acquiring its share (as determined under paragraph (f)(2)(i)(B) of this section) of the property. The expanded group partner is treated as acquiring its share of the property from the transferor member in the manner (for example, in a distribution, in an exchange for property, or in an issuance), and on the date on which, the property is actually acquired by the controlled partnership from the transferor member. Accordingly, this section applies to a member’s acquisition of property described in this paragraph (f)(2)(i)(A) in the same manner as if the member actually acquired the property from the transferor member, unless explicitly provided otherwise.

(B) Expanded group partner’s share of property. For purposes of paragraph (f)(2)(i)(A) of this section, a partner’s share of property acquired by a controlled partnership is determined in accordance with the partner’s liquidation value percentage (as defined in paragraph (g)(17) of this section) with respect to the controlled partnership. The liquidation value percentage is determined on the date on which the controlled partnership acquires the property.

(C) Exception if transferor member is an expanded group partner. If a transferor member is an expanded group partner in the controlled partnership, paragraph (f)(2)(i)(A) of this section does not apply to such partner.

(ii) Acquisitions of expanded group stock when a member of the expanded group becomes a partner after the acquisition—(A) Aggregate treatment. Except as otherwise provided in paragraph (f)(2)(ii)(C) of this section, if a controlled partnership, with respect to an expanded group, owns expanded group stock, and a member of the expanded group becomes an expanded group partner in the controlled partnership, then, for purposes of this section, the member is treated as acquiring its share (as determined under paragraph (f)(2)(ii)(B) of this section) of the expanded group stock owned by the controlled partnership. The member is treated as acquiring its share of the expanded group stock on the date on which the member becomes an expanded group partner. Furthermore, the member is treated as if it acquires its share of the expanded group stock from a member of the expanded group in exchange for property other than expanded group stock, regardless of the manner in which the partnership acquired the stock and in which the member acquires its partnership interest. Accordingly, this section applies to a partner’s acquisition of expanded group stock described in this paragraph (f)(2)(ii)(A) in the same manner as if the member actually acquired the stock from a member of the expanded group in exchange for property other than expanded group stock, unless explicitly provided otherwise.

(B) Expanded group partner’s share of expanded group stock. For purposes of paragraph (f)(2)(ii)(A) of this section, a partner’s share of expanded group stock owned by a controlled partnership is determined in accordance with the partner’s liquidation value percentage with respect to the controlled partnership. The liquidation value percentage is determined on the date on which a member of the expanded group becomes an expanded group partner in the controlled partnership.

(C) Exception if an expanded group partner acquires its interest in a controlled partnership in exchange for expanded group stock. Paragraph (f)(2)(ii)(A) of this section does not apply to a member of an expanded group that acquires its interest in a controlled partnership either from another partner in exchange solely for expanded group stock or upon a partnership contribution to the controlled partnership comprised solely of expanded group stock.

(3) Issuances of debt instruments by a controlled partnership to a member of an expanded group—(i) Aggregate treatment. If a controlled partnership, with respect to an expanded group, issues a debt instrument to a member of the expanded group, then, for purposes of this section, a covered member that is an expanded group partner is treated as the issuer with respect to its share (as determined under paragraph (f)(3)(ii) of this section) of the debt instrument issued by the controlled partnership. This section applies to the portion of the debt instrument treated as issued by the covered member as described in this paragraph (f)(3)(i) in the same manner as if the covered member actually issued the debt instrument to the holder-in-form, unless otherwise provided. See paragraph (f)(4) of this section, which deems a debt instrument issued by a controlled partnership to be held by an expanded group partner rather than the holder-in-form in certain cases.

(ii) Expanded group partner’s share of a debt instrument issued by a controlled partnership—(A) General rule. An expanded group partner’s share of a debt instrument issued by a controlled partnership is determined on each date on which the partner makes a distribution or acquisition described in paragraph (b)(2) or (b)(3)(i) of this section (testing date). An expanded group partner’s share of a debt instrument issued by a controlled partnership to a member of the expanded group is determined in accordance with the partner’s issuance percentage (as defined in paragraph (g)(16) of this section) on the testing date. A partner’s share determined under this paragraph (f)(3)(i)(A) is adjusted as described in paragraph (f)(3)(ii)(B) of this section.

(B) Additional rules if there is a specified portion with respect to a debt instrument—(I) An expanded group partner’s share (as determined under paragraph (f)(3)(ii)(A) of this section) of a debt instrument issued by a controlled partnership is reduced, but not below zero, by the sum of all of the specified portions (as defined in paragraph (g)(23) of this section), if any, with respect to the debt instrument that correspond to one or more deemed transferred receivables (as defined in paragraph (g)(8) of this section) that are deemed to be held by the partner.

(2) If the aggregate of all of the expanded group partners’ shares (as determined under paragraph (f)(3)(ii)(A) of this section and reduced under paragraph (f)(3)(ii)(B)(I) of this section) of the debt instrument exceeds the adjusted issue price of the debt, reduced by the sum of all of the specified portions with respect to the debt instrument that correspond to one
or more deemed transferred receivables that are deemed to be held by one or more expanded group partners (excess amount), then each expanded group partner’s share (as determined under paragraph (f)(3)(ii)(A) of this section and reduced under paragraph (f)(3)(ii)(B)(1) of this section) of the debt instrument is reduced. The amount of an expanded group partner’s reduction is the excess amount multiplied by a fraction, the numerator of which is the partner’s share, and the denominator of which is the aggregate of all of the expanded group partners’ shares.

(iii) **Qualified short-term debt instrument.** The determination of whether a debt instrument is a qualified short-term debt instrument for purposes of paragraph (b)(3)(vii) of this section is made at the partnership-level without regard to paragraph (f)(3)(i) of this section.

(4) **Recharacterization when there is a specified portion with respect to a debt instrument issued by a controlled partnership—(i) General rule.** A specified portion, with respect to a debt instrument issued by a controlled partnership and an expanded group partner, is not treated as stock under paragraph (b)(2) or (b)(3)(i) of this section. Except as otherwise provided in paragraphs (f)(4)(ii) and (iii) of this section, the holder-in-form (as defined in paragraph (g)(15) of this section) of the debt instrument is deemed to transfer a portion of the debt instrument (a deemed transferred receivable, as defined in paragraph (g)(8) of this section) with a principal amount equal to the adjusted issue price of the specified portion to the expanded group partner in exchange for stock in the expanded group partner (deemed partner stock, as defined in paragraph (g)(6) of this section) with a fair market value equal to the principal amount of the deemed transferred receivable. Except as otherwise provided in paragraph (f)(4)(vi) of this section (concerning the treatment of a deemed transferred receivable for purposes of section 752) and paragraph (f)(5) of this section (concerning specified events subsequent to the deemed transfer), the deemed transfer described in this paragraph (f)(4)(i) is deemed to occur for all Federal tax purposes.

(ii) **Expanded group partner is the holder-in-form of a debt instrument.** If the specified portion described in paragraph (f)(4)(i) of this section is with respect to an expanded group partner that is the holder-in-form of the debt instrument, then paragraph (f)(4)(i) of this section will not apply with respect to that specified portion except that only the first sentence of paragraph (f)(4)(i) of this section is applicable.

(iii) **Expanded group partner is a consolidated group member.** This paragraph (f)(4)(iii) applies when one or more expanded group partners is a member of a consolidated group that files (or is required to file) a consolidated U.S. Federal income tax return. In this case, notwithstanding §1.385-4(b)(1) (which generally treats members of a consolidated group as one corporation for purposes of this section), the holder-in-form of the debt instrument issued by the controlled partnership is deemed to transfer the deemed transferred receivable or receivables to the expanded group partner or partners that are members of a consolidated group that make, or are treated as making under paragraph (f)(2) of this section, the regarded distributions or acquisitions (within the meaning of §1.385-4(e)(5)) described in paragraph (b)(2) or (b)(3)(i) of this section in exchange for deemed partner stock in such partner or partners. To the extent those regarded distributions or acquisitions are made by a member of the consolidated group that is not an expanded group partner (excess amount), the holder-in-form is deemed to transfer a portion of the deemed transferred receivable or receivables to each member of the consolidated group that is an expanded group partner in exchange for deemed partner stock in the expanded group partner. The portion is the excess amount multiplied by a fraction, the numerator of which is the portion of the consolidated group’s share (as determined under paragraph (f)(3)(ii) of this section) of the debt instrument issued by the controlled partnership that would have been the expanded group partner’s share if the partner was not a member of a consolidated group, and the denominator of which is the consolidated group’s share of the debt instrument issued by the controlled partnership.

(iv) **Rules regarding deemed transferred receivables and deemed partner stock—(A) Terms of deemed partner stock.** Deemed partner stock has the same terms as the deemed transferred receivable with respect to the deemed transfer, other than the identity of the issuer.

(B) **Treatment of payments with respect to a debt instrument for which there is one or more deemed transferred receivables.** When a payment is made with respect to a debt instrument issued by a controlled partnership for which there is one or more deemed transferred receivables, then, if the amount of the retained receivable (as defined in paragraph (g)(22) of this section) held by the holder-in-form is zero and a single deemed holder is deemed to hold all of the deemed transferred receivables, the entire payment is allocated to the deemed transferred receivables held by the single deemed holder. If the amount of the retained receivable held by the holder-in-form is greater than zero or there are multiple deemed holders of deemed transferred receivables, or both, the payment is apportioned among the retained receivable, if any, and each deemed transferred receivable in proportion to the principal amount of all the receivables. The portion of a payment allocated or apportioned to a retained receivable or a deemed transferred receivable reduces the principal amount of, or accrued interest with respect to, as applicable depending on the payment, the retained receivable or deemed transferred receivable. When a payment allocated or apportioned to a deemed transferred receivable reduces the principal amount of the receivable, the expanded group partner that is the deemed holder with respect to the deemed transferred receivable is deemed to redeem the same amount of deemed partner stock, and the specified portion with respect to the debt instrument is reduced by the same amount. When a payment allocated or apportioned to a deemed transferred receivable reduces accrued interest with respect to the receivable, the expanded group partner that is the deemed holder with respect to the deemed transferred receivable is deemed to make a matching distribution in the same amount with respect to the deemed partner stock. The controlled partnership is treated as the paying agent with respect to the deemed partner stock.

(v) **Holder-in-form transfers debt instrument in a transaction that is not a specified event.** If the holder-in-form transfers the debt instrument (which is
disregarded for Federal tax purposes) to a member of the expanded group or a controlled partnership (and therefore the transfer is not a specified event described in paragraph (f)(5)(iii)(F) of this section), then, for Federal tax purposes, the holder-in-form is deemed to transfer the retained receivable and the deemed partner stock to the transferee.

(vi) Allocation of deemed transferred receivable under section 752. A partnership liability that is a debt instrument with respect to which there is one or more deemed transferred receivables is allocated for purposes of section 752 without regard to any deemed transfer.

(5) Specified events affecting ownership following a deemed transfer—(i) General rule. If a specified event (within the meaning of paragraph (f)(5)(iii) of this section) occurs with respect to a deemed transfer, then, immediately before the specified event, the expanded group partner that is both the issuer of the deemed partner stock and the deemed holder of the deemed transferred receivable is deemed to distribute the deemed transferred receivable (or portion thereof, as determined under paragraph (f)(5)(iv) of this section) to the holder-in-form in redemption of the deemed partner stock (or portion thereof, as determined under paragraph (f)(5)(iv) of this section) deemed to be held by the holder-in-form. The deemed distribution is deemed to occur for all Federal tax purposes, except that the distribution is disregarded for purposes of paragraph (b) of this section. Except when the deemed transferred receivable (or portion thereof, as determined under paragraph (f)(5)(iv) of this section) is deemed to be retransferred under paragraph (f)(5)(ii) of this section, the principal amount of the retained receivable held by the holder-in-form is increased by the principal amount of the deemed transferred receivable, the deemed transferred receivable ceases to exist for Federal tax purposes, and the specified portion (or portion thereof) that corresponds to the deemed transferred receivable (or portion thereof) ceases to be treated as a specified portion for purposes of this section.

(ii) New deemed transfer when a specified event involves a transferee that is a covered member that is an expanded group partner. If the specified event is described in paragraph (f)(5)(iii)(E) of this section, the holder-in-form of the debt instrument is deemed to retransfer the deemed transferred receivable (or portion thereof, as determined under paragraph (f)(5)(iv) of this section) that the holder-in-form is deemed to have received pursuant to paragraph (f)(5)(i) of this section, to the transferee expanded group partner in exchange for deemed partner stock issued by the transferee expanded group partner with a fair market value equal to the principal amount of the deemed transferred receivable (or portion thereof) that is retransferred. For purposes of this section, this deemed transfer is treated in the same manner as a deemed transfer described in paragraph (f)(4)(i) of this section.

(iii) Specified events. A specified event, with respect to a deemed transfer, occurs when, immediately after the transaction and taking into account all related transactions:

(A) The controlled partnership that is the issuer of the debt instrument either ceases to be a controlled partnership or ceases to have an expanded group partner that is a covered member.

(B) The holder-in-form is a member of the expanded group immediately before the transaction, and the holder-in-form and the deemed holder cease to be members of the same expanded group for the reasons described in paragraph (d)(2) of this section.

(C) The holder-in-form is a controlled partnership immediately before the transaction, and the holder-in-form ceases to be a controlled partnership.

(D) The expanded group partner that is both the issuer of deemed partner stock and the deemed holder transfers (directly or indirectly through one or more partnerships) all or a portion of its interest in the controlled partnership to a person that is neither a covered member nor a controlled partnership with an expanded group partner that is a covered member. If there is a transfer of only a portion of the interest, see paragraph (f)(5)(iv) of this section.

(E) The expanded group partner that is both the issuer of deemed partner stock and the deemed holder transfers (directly or indirectly through one or more partnerships) all or a portion of its interest in the controlled partnership to a covered member or a controlled partnership with an expanded group partner that is a covered member. If there is a transfer of only a portion of the interest, see paragraph (f)(5)(iv) of this section.

(F) The holder-in-form transfers the debt instrument (which is disregarded for Federal tax purposes) to a person that is neither a member of the expanded group nor a controlled partnership. See paragraph (f)(4)(v) of this section if the holder-in-form transfers the debt instrument to a member of the expanded group or a controlled partnership.

(iv) Specified event involving a transfer of only a portion of an interest in a controlled partnership. If, with respect to a specified event described in paragraph (f)(5)(iii)(D) or (E) of this section, an expanded group partner transfers only a portion of its interest in a controlled partnership, then, only a portion of the deemed transferred receivable that is deemed to be held by the expanded group partner is deemed to be distributed in redemption of an equal portion of the deemed partner stock. The portion of the deemed transferred receivable referred to in the preceding sentence is equal to the product of the entire principal amount of the deemed transferred receivable deemed to be held by the expanded group partner multiplied by a fraction, the numerator of which is the portion of the expanded group partner’s capital account attributable to the interest that is transferred, and the denominator of which is the expanded group partner’s capital account with respect to its entire interest, determined immediately before the specified event.

(6) Issuance of a partnership’s debt instrument to a partner and a partner’s debt instrument to a partnership. If a controlled partnership, with respect to an expanded group, issues a debt instrument to an expanded group partner, or if a covered member that is an expanded group partner issues a covered debt instrument to a controlled partnership, and in each case, no partner deducts or receives an allocation of expense with respect to the debt instrument, then this section does not apply to the debt instrument.

(g) * * *

(5) Deemed holder. The term deemed holder means, with respect to a deemed transfer, the expanded group partner that is deemed to hold a deemed transferred receivable by reason of the deemed transfer.
(6) Deemed partner stock. The term "deemed partner stock" means, with respect to a deemed transfer, the stock deemed issued by an expanded group partner as described in paragraphs (f)(4)(i) and (iii) and (f)(5)(ii) of this section. The amount of deemed partner stock is reduced as described in paragraphs (f)(4)(iv)(B) and (f)(5)(i) of this section.

(7) Deemed transfer. The term "deemed transfer" means, with respect to a specified portion, the transfer described in paragraph (f)(4)(i) or (iii) or (f)(5)(ii) of this section.

(8) Deemed transferred receivable. The term "deemed transferred receivable" means, with respect to a deemed transfer, the portion of the debt instrument described in paragraph (f)(4)(i) or (iii) or (f)(5)(ii) of this section. The deemed transferred receivable is reduced as described in paragraphs (f)(4)(iv)(B) and (f)(5)(i) of this section.

(15) Holder-in-form. The term "holder-in-form" means, with respect to a debt instrument issued by a controlled partnership, the person that, absent the application of paragraph (f)(4) of this section, would be the holder of the debt instrument for Federal tax purposes. Therefore, the term holder-in-form does not include a deemed holder (as defined in paragraph (g)(5) of this section).

(16) Issuance percentage. The term "issuance percentage" means, with respect to a controlled partnership and an expanded group partner, the ratio (expressed as a percentage) of the partner’s reasonably anticipated distributive share of all the partnership’s interest expense over a reasonable period, divided by all of the partnership’s reasonably anticipated interest expense over that same period, taking into account any and all relevant facts and circumstances. The relevant facts and circumstances include, without limitation, the term of the debt instrument; whether the partnership anticipates issuing other debt instruments; and the partnership’s anticipated section 704(b) income and expense, and the partners’ respective anticipated allocation percentages, taking into account anticipated changes to those allocation percentages over time resulting, for example, from anticipated contributions, distributions, recapitalizations, or provisions in the controlled partnership agreement.

(17) Liquidation value percentage. The term "liquidation value percentage" means, with respect to a controlled partnership and an expanded group partner, the ratio (expressed as a percentage) of the liquidation value of the expanded group partner’s interest in the partnership divided by the aggregate liquidation value of all the partners’ interests in the partnership. The liquidation value of an expanded group partner’s interest in a controlled partnership is the amount of cash the partner would receive with respect to the interest if the partnership (and any partnership through which the partner indirectly owns an interest in the controlled partnership) sold all of its property for an amount of cash equal to the fair market value of the property (taking into account section 7701(g)), satisfied all of its liabilities (other than those described in §1.752-7), paid an unrelated third party to assume all of its §1.752-7 liabilities in a fully taxable transaction, and then the partnership (and any partnership through which the partner indirectly owns an interest in the controlled partnership) liquidated.

(22) Retained receivable. The term "retained receivable" means, with respect to a debt instrument issued by a controlled partnership, the portion of the debt instrument that is not transferred by the holder-in-form pursuant to one or more deemed transfers. The retained receivable is adjusted for decreases described in paragraph (f)(4)(iv)(B) of this section and increases described in paragraph (f)(5)(i) of this section.

(23) Specified portion. The term "specified portion" means, with respect to a debt instrument issued by a controlled partnership and a covered member that is an expanded group partner, the portion of the debt instrument that is treated under paragraph (f)(3)(i) of this section as issued on a testing date (within the meaning of paragraph (f)(3)(ii) of this section) by the covered member and that, absent the application of paragraph (f)(4)(i) of this section, would be treated as stock under paragraph (b)(2) or (b)(3)(i) of this section on the testing date. A specified portion is reduced as described in paragraphs (f)(4)(iv)(B) and (f)(5)(i) of this section.

(3) * * * * *

(ii) Example 12: Distribution of a covered debt instrument to a controlled partnership—(A) Facts. CFC and FS are equal partners in PRS. PRS owns 100% of the stock in X Corp, a domestic corporation. On Date A in Year 1, X Corp issues X Note to PRS in a distribution.

(B) Analysis. (1) Under §1.385-1(c)(4), in determining whether X Corp is a member of the FP expanded group that includes CFC and FS, CFC and FS are each treated as owning 50% of the X Corp stock held by PRS. Accordingly, 100% of X Corp’s stock is treated as owned by CFC and FS, and X Corp is a member of the FP expanded group.

(2) Together CFC and FS own 100% of the interests in PRS capital and profits, such that PRS is a controlled partnership under §1.385-1(c)(1). CFC and FS are both expanded group partners on the date on which PRS acquired X Note. Therefore, pursuant to paragraph (f)(2)(i)(A) of this section, each of CFC and FS is treated as acquiring its share of X Note in the same manner (in this case, by a distribution of X Note), and on the date on which, PRS acquired X Note. Likewise, X Corp is treated as issuing to each of CFC and FS its share of X Note. Under paragraph (f)(2)(i)(B) of this section, each of CFC’s and FS’s share of X Note, respectively, is determined in accordance with its liquidation value percentage determined on Date A in Year 1, the date X Corp distributed X Note to PRS. On Date A in Year 1, pursuant to paragraph (g)(17) of this section, each of CFC’s and FS’s liquidation value percentages is 50%. Accordingly, on Date A in Year 1, under paragraph (f)(2)(i)(A) of this section, for purposes of this section, CFC and FS are each treated as acquiring 50% of X Note in a distribution.

(3) Under paragraphs (b)(2)(i) and (d)(1)(i) of this section, X Note is treated as stock on the date of issuance, which is Date A in Year 1. Under paragraph (f)(2)(i)(A) of this section, each of CFC and FS is treated as acquiring 50% of X Note in a distribution for purposes of this section. Therefore, X Corp is treated as distributing its stock to PRS in a distribution described in section 305.

(xiii) Example 13: Loan to a controlled partnership; proportionate distributions by expanded group partners—(A) Facts. DS, USS2, and USP are partners in PRS. USP is a domestic corporation that is not a member of the FP expanded group. Each of DS and USS2 own 45% of the interests in PRS profits and capital, and USP owns 10% of the interests in PRS profits and capital. The PRS partnership agreement provides that all items of PRS income, gain, loss, deduction, and credit are allocated in accordance with the percentages in the preceding sentence. On Date A in Year 1, FP lends $200x to PRS in exchange for PRS Note with stated principal amount of $200x, which is payable at maturity. PRS Note also provides for annual payments of interest that are qualified stated interest. PRS uses all $200x in its business and does not distribute any money or other property to a partner. Subsequently, on Date B in Year 1, DS distributes $90x to USS1, USS2 distributes $90x to FP, and USP distributes $20x to its shareholder. Each of DS’s and USS2’s issuance percentage is 45% on Date B in Year 1, the date of the distributions and
therefore a testing date under paragraph (f)(3)(ii)(A) of this section.

(B) Analysis. (1) DS and USS2 together own 90% of the interests in PRS profits and capital and therefore PRS is a controlled partnership under §1.385-1(c)(1). Under §1.385-1(c)(2), each of DS and USS2 is a covered member.

Under paragraph (f)(3)(ii)(A) of this section, each of DS and USS2 is treated as issuing its share of PRS Note, and under paragraph (f)(3)(iii)(A) of this section, the portions of PRS Note treated as issued by each of DS and USS2 are treated as funding the distribution made by DS and USS2 because the distributions occurred within the per se period with respect to PRS Note. Under paragraph (b)(3)(iii)(A) of this section, the portions of PRS Note treated as issued by each of DS and USS2 would, absent the application of paragraph (f)(4)(i) of this section, be treated as stock of DS and USS2 on Date B in Year 1, the date of the distributions. See paragraph (d)(1)(i) of this section. Under paragraph (g)(23) of this section, §45x of PRS Note is a specified portion with respect to DS and $90x of PRS Note is a specified portion with respect to USS2.

(2) Under paragraph (f)(4)(i) of this section, the specified portions are not treated as stock under paragraph (b)(3)(i) of this section. Instead, USS2 is deemed to transfer a portion of PRS Note with a principal amount of $45x (the adjusted issue price of the specified portion with respect to DS) to DS in exchange for stock of DS with a fair market value of $90x. Similarly, USS2 is deemed to transfer a portion of PRS Note with a principal amount equal to $90x (the adjusted issue price of the specified portion with respect to USS2) to USS2 in exchange for stock of USS2 with a fair market value of $90x. The principal amount of the retained receivable held by USS2 is $65x ($200x-$545x-$90x).

Example 15: Loan to a controlled partnership; distribution in later year—(A) Facts. The facts are the same as in paragraph (b)(3)(xii)(B)(1) of this section (Example 13), except that USS2 does not distribute $90x to USS2 until Date C in Year 2, which is less than 36 months after Date A in Year 1. On Date C in Year 2, DS’s, USS2’s, and USS2’s issuance percentages under paragraph (g)(16) of this section are unchanged at 45%, 45%, and 10%, respectively.

(B) Analysis. (1) The analysis is the same as in paragraph (b)(3)(xii)(B)(1) of this section (Example 13).

(2) The analysis is the same as in paragraph (b)(3)(xii)(B)(2) of this section (Example 13).

(3) With respect to the distribution made by DS, the analysis is the same as in paragraph (b)(3)(xii)(B)(3) of this section (Example 13).

(4) With respect to the deemed transfer to USS2, the analysis is the same as in paragraph (b)(3)(xii)(B)(4) of this section (Example 13). Accordingly, the amount of the retained receivable held by USS2 as of Date B in Year 1 is $110x ($200x-$90x).

Under paragraph (f)(3)(ii)(A) of this section, USS2’s share of PRS Note is determined on Date C in Year 2. On Date C in Year 2, DS’s, USS2’s, and USP’s respective shares of PRS Note under paragraph (f)(3)(ii)(A) of this section are $90x, $90x, and $20x. However, because DS is treated as the issuer with respect to a $90x specified portion of PRS Note, DS’s share of PRS Note is reduced by $90x to $0 under paragraph (f)(3)(ii)(B)(1) of this section. No reduction to either of USS2’s or USP’s share of PRS Note is required under paragraph (f)(3)(ii)(B)(2) of this section because the aggregate of DS’s, USS2’s, and USP’s shares of PRS Note as reduced is $110x (DS has a $0 share, USS2 has a $90x share, and USP has a $20x share), which does not exceed $110x (the $200x adjusted issue price of PRS Note reduced by the $90x specified portion with respect to DS). Under paragraph (f)(3)(i) of this section, USS2 is treated as issuing its share of PRS Note.

(5) The $90x distribution made by USS2 to FP is described in paragraph (b)(3)(i)(A) of this section. Under paragraph (b)(3)(iii)(A) of this section, the portion of PRS Note treated as issued by USS2 is treated as funding the distribution made by USS2, because the distribution occurred within the per se period with respect to PRS Note. Accordingly, the portion of PRS Note treated as issued by USS2 would, absent the application of paragraph (f)(4)(i) of this section, be treated as stock of USS2 under paragraph (b)(3)(i)(A) of this section on Date C in Year 2. See paragraph (d)(1)(ii) of this section. Under paragraph (g)(23) of this section, the $90x portion is a specified portion.

(6) Under paragraph (f)(4)(i) of this section, the specified portion is not treated as stock under paragraph (b)(3)(i) of this section. Instead, FP is deemed to transfer a portion of PRS Note with a principal amount equal to $45x (the adjusted issue price of the specified portion with respect to DS) to DS in exchange for stock of DS with a fair market value of $90x. Similarly, FP is deemed to transfer a portion of PRS Note with a principal amount equal to $90x (the adjusted issue price of the specified portion with respect to USS2) to USS2 in exchange for stock of USS2 with a fair market value of $90x. The principal amount of the retained receivable held by FP is $65x ($200x-$545x-$90x).

Example 16: Loan to a controlled partnership; partnership ceases to be a controlled partnership—(A) Facts. The facts are the same as in paragraph (h)(3)(xiii)(A) of this section (Example 13), except that on Date C in Year 4, USS2 sells its entire interest in PRS to an unrelated person.

(B) Analysis. (1) On Date C in Year 4, PRS ceases to be a controlled partnership with respect to the FP expanded group under §1.385-1(c)(1). This is the case because DS, the only remaining partner that is a member of the FP expanded group, owns 45% of the total interest in PRS profits and capital. Because PRS ceases to be a controlled partnership, a specified event (within the meaning of paragraph (f)(5)(iii)(A) of this section) occurs with respect to the deemed transfers with respect to each of DS and USS2.

(2) Under paragraph (f)(5)(i) of this section, on Date C in Year 4, immediately before PRS ceases to be a controlled partnership, each of DS and USS2 is deemed to distribute its deemed transferred receivable to FP in redemption of FP’s deemed partner stock in DS and USS2. The specified portion that corresponds to each of the deemed transferred receivables cease to exist, and the retained receivable held by FP increases from $20x to $200x.

Example 17: Transfer of an interest in a partnership to a covered member—(A) Facts. The facts are the same as in paragraph (h)(3)(xiii)(A) of this section (Example 13), except that on Date C in Year 4, USS2 sells its entire interest in PRS to USS1.

(B) Analysis. (1) After USS2 sells its interest in PRS to USS1, DS and USS1 together own 90% of the interests in PRS profits and capital and therefore PRS continues to be a controlled partnership under §1.385-1(c)(1). A specified event (within the meaning of paragraph (f)(5)(iii)(E) of this section) occurs as a result of the sale only with respect to the deemed transfer with respect to USS2.

(2) Under paragraph (f)(5)(i) of this section, on Date C in Year 4, immediately before USS2 sells its entire interest in PRS to USS1, USS2 is deemed to distribute its deemed transferred receivable to FP in redemption of FP’s deemed partner stock in USS2. Because the specified event is described in paragraph...
(f)(5)(iii)(E) of this section, under paragraph (f)(5)(ii) of this section, FP is deemed to retransfer the deemed transferred receivable deemed received from USS2 to USS1 in exchange for deemed partner stock in USS1 with a fair market value equal to the principal amount of the deemed transferred receivable that is retransferred to USS1.

(xviii) Example 18: Loan to partnership and all partners are members of a consolidated group—

(A) Facts. USS1 and DS are equal partners in PRS. USS1 and DS are members of a consolidated group, as defined in §1.1502-1(h). The PRS partnership agreement provides that all items of PRS income, gain, loss, deduction, and credit are allocated equally between USS1 and DS. On Date A in Year 1, FP lends $200x to USS1 in exchange for PRS Note. PRS uses all $200x in its business and does not distribute any money or other property to any partner. On Date B in Year 1, DS distributes $200x to USS1, and USS1 distributes $200x to FP. If neither of USS1 or DS were a member of the consolidated group, each would have an issuance percentage under paragraph (g)(16) of this section, determined as of Date A in Year 1, of 50%.

(B) Analysis. (1) Pursuant to §1.385-4(b)(6), PRS is treated as a partnership for purposes of this section. Under §1.385-4(b)(1), DS and USS1 are treated as one corporation for purposes of this section, and thus a single covered member under §1.385-1(c)(2). For purposes of this section, the single covered member owns 100% of the PRS profits and capital and therefore PRS is a controlled partnership under §1.385-1(c)(1). Under paragraph (f)(3)(i) of this section, the single covered member is treated as issuing all $200x of PRS Note to FP; a member of the same expanded group as the single covered member. DS’s distribution to USS1 is a disregarded distribution because it is a distribution between members of a consolidated group that is disregarded under the one-corporation rule described in §1.385-4(b)(1). However, under paragraph (b)(3)(iii)(A) of this section, PRS Note, treated as issued by the single covered member, is treated as funding the distribution to USS1 to FP, which is described in paragraph (b)(3)(i)(A) of this section and which is a disregarded distribution. Accordingly, PRS Note, absent the application of paragraph (f)(4)(i) of this section, would be treated as stock under paragraph (b) of this section on Date B in Year 1. Thus, pursuant to paragraph (g)(23) of this section, the entire PRS Note is a specified portion.

(2) Under paragraphs (f)(4)(i) and (iii) of this section, the specified portion is not treated as stock and, instead, FP is deemed to transfer PRS Note with a principal amount equal to $200x to USS1 in exchange for stock of USS1 with a fair market value of $200x. Under paragraph (f)(4)(iii) of this section, FP is deemed to transfer PRS Note to USS1 because only USS1 made a disregarded distribution described in paragraph (b)(3)(i) of this section.

(xix) Example 19: Loan to a disregarded entity—

(A) Facts. DS owns DRE, a disregarded entity within the meaning of §1.385-1(c)(3). On Date A in Year 1, FP lends $200x to DRE in exchange for DRE Note. Subsequently, on Date B in Year 1, DS distributes $100x of cash to USS1.

(B) Analysis. Under paragraph (b)(3)(iii)(A) of this section, $100x of DRE Note would be treated as funding the distribution by DS to USS1 because DRE Note is issued to a member of the FP expanded group during the per se period with respect to DS’s distribution to USS1. Accordingly, under paragraphs (b)(3)(i)(A) and (d)(1)(ii) of this section, $100x of DRE Note would be treated as stock on Date B in Year 1. However, under paragraph (d)(4) of this section, DS, as the regarded owner, within the meaning of §1.385-1(c)(5), of DRE is deemed to issue its stock to FP in exchange for a portion of DRE Note equal to the $100x applicable portion (as defined in paragraph (d)(4) of this section). Thus, DS is treated as the holder of $100x of DRE Note, which is disregarded, and FP is treated as the holder of the remaining $100x of DRE Note. The $100x of stock deemed issued by DS to FP has the same terms as DRE Note, other than the issuer, and payments on the stock are determined by reference to payments on DRE Note.

**** *(1) In general. Except as provided in paragraph (j)(2) or (3) or (k) of this section, this section applies to taxable years ending on or after January 19, 2017.

(3) Paragraph (f)(4)(iii) of this section. Paragraph (f)(4)(iii) of this section applies to taxable years for which the U.S. Federal income tax return is due, without extensions, after May 14, 2020. For taxable years ending on or after January 19, 2017, and for which the U.S. Federal income tax return is due, without extensions, on or before May 14, 2020, see §1.385-3T(f)(4)(iii), as contained in 26 CFR in part 1 in effect on April 1, 2019. In the case of a taxable year that ends after October 13, 2019, and on or before May 14, 2020, a taxpayer may choose to apply paragraph (f)(4)(iii) of this section to the portion of the taxable year that occurs after the expiration of §1.385-3T on October 13, 2019, provided that all members of the taxpayer’s expanded group apply such paragraph.

(k) Additional transition rules. See transition rules in §1.385-3T(k)(2) as contained in 26 CFR in part 1 in effect on April 1, 2019.

$§1.385-3T and 1.385-4T [Removed] Par. 4. Sections 1.385-3T and 1.385-4T are removed.

Par. 5. Section 1.385-4 is added to read as follows:

§1.385-4 Treatment of consolidated groups.

(a) Scope. This section provides rules for applying §1.385-3 to members of consolidated groups. Paragraph (b) of this section sets forth rules concerning the extent to which, solely for purposes of applying §1.385-3, members of a consolidated group that file (or that are required to file) a consolidated U.S. Federal income tax return are treated as one corporation. Paragraph (c) of this section sets forth rules concerning the treatment of a debt instrument that ceases to be, or becomes, a consolidated group debt instrument. Paragraph (d) of this section provides rules for applying the funding rule of §1.385-3(b)(3) to members that depart a consolidated group. For definitions applicable to this section, see paragraph (e) of this section and §§1.385-1(c) and 1.385-3(g). For examples illustrating the application of this section, see paragraph (f) of this section.

(b) Treatment of consolidated groups—

(1) Members treated as one corporation. For purposes of this section and §1.385-3, and except as otherwise provided in this section and §1.385-3, all members of a consolidated group (as defined in §1.1502-1(h)) that file (or that are required to file) a consolidated U.S. Federal income tax return are treated as one corporation. Thus, for example, when a member of a consolidated group issues a covered debt instrument that is not a consolidated group debt instrument, the consolidated group generally is treated as the issuer of the covered debt instrument for purposes of this section and §1.385-3. Also, for example, when one member of a consolidated group issues a covered debt instrument that is not a consolidated group debt instrument and therefore is treated as issued by the consolidated group, and another member of the consolidated group makes a distribution or acquisition described in §1.385-3(b)(3)(i)(A) through (C) with an expanded group member that is not a member of the consolidated group, §1.385-3(b)(3)(i) may treat the covered debt instrument as funding the distribution or acquisition made by the consolidated group. In addition, except as otherwise provided in this section, acquisitions and distributions described in §1.385-3(b)(2) and (b)(3)(i) in which all parties to the transaction are members of the same consolidated group both before and after the transaction are disregarded for purposes of this section and §1.385-3.

(2) One-corporation rule inapplicable to expanded group member determination. The one-corporation rule described in paragraph (b)(1) of this section does not apply in determining the members of an
expanded group. Notwithstanding the previous sentence, an expanded group does not exist for purposes of this section and §1.385-3 if it consists only of members of a single consolidated group.

3. Application of §1.385-3 to debt instruments issued by members of a consolidated group—(i) Debt instrument treated as stock of the issuing member of a consolidated group. If a covered debt instrument treated as stock by a member of a consolidated group under the one-corporation rule described in paragraph (b)(1) of this section is treated as stock under §1.385-3, the covered debt instrument is treated as stock in the member of the consolidated group that would be the issuer of such debt instrument without regard to this section. But see §1.385-3(d)(7) (providing that a covered debt instrument is treated as stock under §1.385-3(b)(2), (3), or (4) and that is not described in section 1504(a)(4) is not treated as stock for purposes of determining whether the issuer is a member of an affiliated group (within the meaning of section 1504(a)).

(ii) Application of the covered debt instrument exclusions. For purposes of determining whether a debt instrument issued by a member of a consolidated group is a covered debt instrument, each test described in §1.385-3(g)(3) is applied on a separate member basis without regard to the one-corporation rule described in paragraph (b)(1) of this section.

(iii) Qualified short-term debt instrument. The determination of whether a member of a consolidated group has issued a qualified short-term debt instrument for purposes of §1.385-3(b)(3)(vii) is made on a separate member basis without regard to the one-corporation rule described in paragraph (b)(1) of this section.

4. Application of the reductions of §1.385-3(c)(3) to members of a consolidated group—(i) Application of the reduction for expanded group earnings—(A) In general. A consolidated group maintains one expanded group earnings account with respect to an expanded group period, and only the earnings and profits, determined in accordance with §1.1502-33 (without regard to the application of §1.1502-33(b)(2), (e), and (f)), of the common parent (within the meaning of section 1504) of the consolidated group are considered in calculating the expanded group earnings for the expanded group period of the consolidated group. Accordingly, a qualified distribution or acquisition made by a member of a consolidated group is reduced to the extent of the expanded group earnings account of the consolidated group.

(B) Effect of certain corporate transactions on the calculation of expanded group earnings—(1) Consolidation. A consolidated group succeeds to the expanded group earnings account of a joining member in accordance with §1.1502-33 (without regard to an expanded group period, if any, is allocated to a departing member. Accordingly, immediately after leaving the consolidated group, the departing member has no expanded group earnings account with respect to its expanded group period.

(ii) Allocation of expanded group earnings to a departing member in a distribution described in section 355. If a departing member leaves the consolidated group by reason of an exchange or distribution to which section 355 (or so much of section 356 that relates to section 355) applies, the expanded group earnings account of a consolidated group is allocated between the consolidated group and the departing member in proportion to the earnings and profits of the consolidated group and the earnings and profits of the departing member immediately after the transaction.

(ii) Application of the reduction for qualified contributions—(A) In general. For purposes of applying §1.385-3(c)(3)(ii)(A) to a consolidated group—

(1) A qualified contribution to any member of a consolidated group that remains a member of the consolidated group immediately after the qualified contribution is made to a person other than a member of the same consolidated group is treated as made to the one corporation described in paragraph (b)(1) of this section;

(2) A qualified contribution that causes a member of a consolidated group to become a departing member of that consolidated group is treated as made to the departing member and not to the consolidated group of which the departing member was a member immediately prior to the qualified contribution; and

(3) No contribution of property by a member of a consolidated group to any other member of the consolidated group is a qualified contribution.

(B) Effect of certain corporate transactions on the calculation of qualified contributions—(1) Consolidation. A consolidated group succeeds to the qualified contributions of a joining member in accordance with §1.385-3(c)(3)(ii)(F)(2)(ii).

(2) Deconsolidation—(i) In general. Except as otherwise provided in paragraph (b)(4)(ii)(B)(2)(ii) of this section, no amount of the qualified contributions of a consolidated group for an expanded group period, if any, is allocated to a departing member. Accordingly, immediately after leaving the consolidated group, the departing member has no qualified contributions with respect to its expanded group period.

(ii) Allocation of qualified contributions to a departing member in a distribution described in section 355. If a departing member leaves the consolidated group by reason of an exchange or distribution to which section 355 (or so much of section 356 that relates to section 355) applies, each qualified contribution of the consolidated group is allocated between the consolidated group and the departing member in proportion to the earnings and profits of the consolidated group and the earnings and profits of the departing member immediately after the transaction.

(5) Order of operations. For purposes of this section and §1.385-3, the consequences of a transaction involving one or more members of a consolidated group are determined as provided in paragraphs (b)(5)(i) and (ii) of this section.

(i) First, determine the characterization of the transaction under Federal tax law without regard to the one-corporation rule described in paragraph (b)(1) of this section.

(ii) Second, apply this section and §1.385-3 to the transaction as characterized to determine whether to treat a debt instrument as stock, treating the consolidated group as one corporation under paragraph (b)(1) of this section, unless otherwise provided.
(6) **Partnership owned by a consolidated group.** For purposes of this section and §1.385-3, and notwithstanding the one-corporation rule described in paragraph (b)(1) of this section, a partnership that is wholly owned by members of a consolidated group is treated as a partnership. Thus, for example, if members of a consolidated group own all of the interests in a controlled partnership that issues a debt instrument to a member of the consolidated group, such debt instrument would be treated as a consolidated group debt instrument because, under §1.385-3(f)(3)(i), for purposes of this section and §1.385-3, a consolidated group member that is an expanded group partner is treated as the issuer with respect to its share of the debt instrument issued by the partnership.

(7) **Predecessor and successor—(i) In general.** Pursuant to paragraph (b)(5) of this section, the determination as to whether a member of an expanded group is a predecessor or successor of another member of the consolidated group is made without regard to paragraph (b)(1) of this section. For purposes of §1.385-3(b)(3), if a consolidated group member is a predecessor or successor of a member of the same expanded group that is not a member of the same consolidated group, the consolidated group is treated as a predecessor or successor of the expanded group member (or the consolidated group of which that expanded group member is a member). Thus, for example, a departing member that departs a consolidated group in a distribution or exchange to which section 355 applies is a successor to the consolidated group and the consolidated group is a predecessor of the departing member.

(ii) **Joining members.** For purposes of §1.385-3(b)(3), the term predecessor also means, with respect to a consolidated group, a joining member and the term successor also means, with respect to a joining member, a consolidated group.

(c) **Consolidated group debt instruments—(1) Debt instrument ceases to be a consolidated group debt instrument but continues to be issued and held by expanded group members—(i) Consolidated group member leaves the consolidated group.** For purposes of this section and §1.385-3, when a debt instrument ceases to be a consolidated group debt instrument as a result of a transaction in which the member of the consolidated group that issued the instrument (the issuer) or the member of the consolidated group holding the instrument (the holder) ceases to be a member of the same consolidated group but both the issuer and the holder continue to be members of the same expanded group, the issuer is treated as issuing a new debt instrument to the holder in exchange for property immediately after the debt instrument ceases to be a consolidated group debt instrument. To the extent the newly-issued debt instrument is a covered debt instrument that is treated as stock under §1.385-3(b)(3), the covered debt instrument is then immediately deemed to be exchanged for stock of the issuer. For rules regarding the treatment of the deemed exchange, see §1.385-1(d). For examples illustrating the rule in this paragraph (c)(1)(i), see paragraphs (f)(3)(iv) and (v) of this section (Examples 4 and 5).

(ii) **Consolidated group debt instrument that is transferred outside of the consolidated group.** For purposes of this section and §1.385-3, when a member of a consolidated group that holds a consolidated group debt instrument transfers the debt instrument to an expanded group member that is not a member of the same consolidated group (transferee expanded group member), the debt instrument is treated as issued by the consolidated group to the transferee expanded group member immediately after the debt instrument ceases to be a consolidated group debt instrument. Thus, for example, for purposes of this section and §1.385-3, the sale of a consolidated group debt instrument to a transferee expanded group member is treated as an issuance of the debt instrument by the consolidated group to the transferee expanded group member in exchange for property. To the extent the newly-issued debt instrument is a covered debt instrument that is treated as stock upon being transferred, the covered debt instrument is deemed to be exchanged for stock of the member of the consolidated group treated as the issuer of the debt instrument (determined under paragraph (b)(3)(i) of this section) immediately after the covered debt instrument is transferred outside of the consolidated group. For rules regarding the treatment of the deemed exchange, see §1.385-1(d). For examples illustrating the rule in this paragraph (c)(1)(ii), see paragraphs (f)(3)(ii) and (iii) of this section (Examples 2 and 3).

(iii) **Overlap transactions.** If a debt instrument ceases to be a consolidated group debt instrument in a transaction to which both paragraphs (c)(1)(i) and (ii) of this section apply, then only the rules of paragraph (c)(1)(ii) of this section apply with respect to such debt instrument.

(iv) **Subgroup exception.** A debt instrument is not treated as ceasing to be a consolidated group debt instrument for purposes of paragraphs (c)(1)(i) and (ii) of this section if both the issuer and the holder of the debt instrument are members of the same consolidated group immediately after the transaction described in paragraph (c)(1)(i) or (ii) of this section.

(2) **Covered debt instrument treated as stock becomes a consolidated group debt instrument.** When a covered debt instrument that is treated as stock under §1.385-3 becomes a consolidated group debt instrument, then immediately after the covered debt instrument becomes a consolidated group debt instrument, the issuer is deemed to issue a new covered debt instrument to the holder in exchange for the covered debt instrument that was treated as stock. In addition, in a manner consistent with §1.385-3(d)(2)(ii)(A), when the covered debt instrument that previously was treated as stock becomes a consolidated group debt instrument, other covered debt instruments issued by the issuer of that instrument (including a consolidated group that includes the issuer) that are not treated as stock when the instrument becomes a consolidated group debt instrument are re-tested to determine whether those other covered debt instruments are treated as funding the regarded distribution or acquisition that previously was treated as funded by the instrument (unless such distribution or acquisition is disregarded under paragraph (b)(1) of this section). Further, also in a manner consistent with §1.385-3(d)(2)(ii)(A), a covered debt instrument that is issued by the issuer (including a consolidated group that includes the issuer) after the application of this paragraph (c)(2) and within the per se period may also be treated as funding that regarded distribution or acquisition.

(3) **No interaction with the intercompany obligation rules of §1.1502-13(g).**
The rules of this section do not affect the application of the rules of §1.1502-13(g). Thus, any deemed satisfaction and reissuance of a debt instrument under §1.1502-13(g) and any deemed issuance and deemed exchange of a debt instrument under this paragraph (c) that arise as part of the same transaction or series of transactions are not integrated. Rather, each deemed satisfaction and reissuance under the rules of §1.1502-13(g), and each deemed issuance and exchange under the rules of this section, are respected as separate steps and treated as separate transactions.

(d) Application of the funding rule of §1.385-3(b)(3) to members departing a consolidated group. This paragraph (d) provides rules for applying the funding rule of §1.385-3(b)(3) when a departing member ceases to be a member of a consolidated group, but only if the departing member and the consolidated group are members of the same expanded group immediately after the deconsolidation.

(1) Continued application of the one-corporation rule. A disregarded distribution or acquisition by any member of the consolidated group continues to be disregarded when the departing member ceases to be a member of the consolidated group.

(2) Continued recharacterization of a departing member’s covered debt instrument as stock. A covered debt instrument of a departing member that is treated as stock of the departing member under §1.385-3(b) continues to be treated as stock when the departing member ceases to be a member of the consolidated group.

(3) Effect of issuances of covered debt instruments that are not consolidated group debt instruments on the departing member and the consolidated group. If a departing member has issued a covered debt instrument (determined without regard to the one-corporation rule described in paragraph (b)(1) of this section) that is not a consolidated group debt instrument and that is not treated as stock immediately before the departing member ceases to be a consolidated group member, then the departing member (and not the consolidated group) is treated as issuing the covered debt instrument on the date and in the manner the covered debt instrument was issued. If the departing member is not treated as the issuer of a covered debt instrument pursuant to the preceding sentence, then the consolidated group continues to be treated as issuing the covered debt instrument on the date and in the manner the covered debt instrument was issued.

(4) Treatment of prior regarded distributions or acquisitions. This paragraph (d)(4) applies when a departing member ceases to be a consolidated group member in a transaction other than a distribution to which section 355 (or so much of section 356 as relates to section 355) applies, and the consolidated group has made a regarded distribution or acquisition. In this case, to the extent the distribution or acquisition has not caused a covered debt instrument of the consolidated group to be treated as stock under §1.385-3(b) on or before the date the departing member leaves the consolidated group, then—

(i) If the departing member made the regarded distribution or acquisition (determined without regard to the one-corporation rule described in paragraph (b)(1) of this section), the departing member (and not the consolidated group) is treated as having made the regarded distribution or acquisition.

(ii) If the departing member did not make the regarded distribution or acquisition (determined without regard to the one-corporation rule described in paragraph (b)(1) of this section), then the consolidated group (and not the departing member) continues to be treated as having made the regarded distribution or acquisition.

(e) Definitions. The definitions in this paragraph (e) apply for purposes of this section.

(1) Consolidated group debt instrument. The term consolidated group debt instrument means a covered debt instrument issued by a member of a consolidated group and held by a member of the same consolidated group.

(2) Departing member. The term departing member means a member of an expanded group that ceases to be a member of a consolidated group but continues to be a member of the same expanded group. In the case of multiple members leaving a consolidated group as a result of a single transaction that continue to be members of the same expanded group, if such members are treated as one corporation under paragraph (b)(1) of this section immediately after the transaction, that one corporation is a departing member with respect to the consolidated group.

(3) Disregarded distribution or acquisition. The term disregarded distribution or acquisition means a distribution or acquisition described in §1.385-3(b)(2) or (b)(3)(i) between members of a consolidated group that is disregarded under the one-corporation rule described in paragraph (b)(1) of this section.

(4) Joining member. The term joining member means a member of an expanded group that becomes a member of a consolidated group and continues to be a member of the same expanded group. In the case of multiple members joining a consolidated group as a result of a single transaction that continue to be members of the same expanded group, if such members were treated as one corporation under paragraph (b)(1) of this section immediately before the transaction, that one corporation is a joining member with respect to the consolidated group.

(5) Regarded distribution or acquisition. The term regarded distribution or acquisition means a distribution or acquisition described in §1.385-3(b)(2) or (b)(3)(i) that is not disregarded under the one-corporation rule described in paragraph (b)(1) of this section.

(f) Examples—(1) Assumed facts. Except as otherwise stated, the following facts are assumed for purposes of the examples in paragraph (f)(3) of this section:

(i) FP is a foreign corporation that owns 100% of the stock of USS1, a covered member, and 100% of the stock of FS, a foreign corporation;

(ii) USS1 owns 100% of the stock of DS1 and DS3, both covered members;

(iii) DS1 owns 100% of the stock of DS2, a covered member;

(iv) FS owns 100% of the stock of UST, a covered member;

(v) At the beginning of Year 1, FP is the common parent of an expanded group comprised solely of FP, USS1, FS, DS1, DS2, DS3, and UST (the FP expanded group);

(vi) USS1, DS1, DS2, and DS3 are members of a consolidated group of which USS1 is the common parent (the USS1 consolidated group);
(vii) The FP expanded group has an outstanding more than $50 million of debt instruments described in §1.385-3(c)(4) at all times;

(viii) No issuer of a covered debt instrument has a positive expanded group earnings account, within the meaning of §1.385-3(c)(3)(i)(B), or has received a qualified contribution, within the meaning of §1.385-3(c)(3)(ii)(B);

(ix) All notes are covered debt instruments, within the meaning of §1.385-3(g)(3), and are not qualified short-term debt instruments, within the meaning of §1.385-3(b)(3)(vii);

(x) All notes between members of a consolidated group are intercompany obligations within the meaning of §1.1502-13(g)(2)(ii);

(xi) Each entity has as its taxable year the calendar year;

(xii) No domestic corporation is a United States real property holding corporation within the meaning of section 897(c)(2);

(xiii) Each note is issued with adequate stated interest (as defined in section 1274(c)(2)); and


(2) No inference. Except as otherwise provided in this section, it is assumed for purposes of the examples in paragraph (f) (3) of this section that the form of each transaction is respected for Federal tax purposes. No inference is intended, however, as to whether any particular note would be respected as indebtedness or as to whether the form of any particular transaction described in an example in paragraph (f)(3) of this section would be respected for Federal tax purposes.

(3) Examples. The following examples illustrate the rules of this section.

(i) Example 1: Order of operations—(A) Facts. On Date A in Year 1, UST issues UST Note to USS1 in exchange for DS3 stock representing less than 20% of the value and voting power of DS3. On Date A in Year 1, DS1 issues DS1 Note to USS1 in a distribution. On Date B in Year 2, USS1 distributes DS1 Note to FP.

(B) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to another member of DS1’s expanded group in a distribution for purposes of §1.385-3(b)(2), and DS1 Note is not treated as stock under §1.385-3. When USS1 distributes DS1 Note to FP, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, when USS1 distributes DS1 Note to FP, the USS1 consolidated group is treated as issuing DS1 Note to FP in a distribution on Date B in Year 2. Accordingly, DS1 Note is treated as stock under §1.385-3(b)(2)(i). Under paragraph (c)(1)(ii) of this section, DS1 Note is deemed to be exchanged for stock of the issuing member, DS1, immediately after DS1 Note is transferred outside of the USS1 consolidated group. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-13(g)(3)(ii) and the deemed issuance and exchange under paragraph (c)(1)(ii) of this section, are respected as separate steps and treated as separate transactions.

(ii) Example 2: Distribution of consolidated group debt instrument—(A) Facts. On Date A in Year 1, DS1 issues DS1 Note to USS1 in a distribution. On Date B in Year 2, USS1 distributes DS1 Note to FP.

(B) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to another member of DS1’s expanded group in a distribution for purposes of §1.385-3(b)(2), and DS1 Note is not treated as stock under §1.385-3. When USS1 distributes DS1 Note to FP, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, when USS1 distributes DS1 Note to FP, the USS1 consolidated group is treated as issuing DS1 Note to FP in a distribution on Date B in Year 2. Accordingly, DS1 Note is treated as stock under §1.385-3(b)(2)(i). Under paragraph (c)(1)(ii) of this section, DS1 Note is deemed to be exchanged for stock of the issuing member, DS1, immediately after DS1 Note is transferred outside of the USS1 consolidated group. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-13(g)(3)(ii) and the deemed issuance and exchange under paragraph (c)(1)(ii) of this section, are respected as separate steps and treated as separate transactions.

(iii) Example 3: Sale of consolidated group debt instrument—(A) Facts. On Date A in Year 1, DS1 lends $200x of cash to USS1 in exchange for USS1 Note. On Date B in Year 2, USS1 distributes $200x of cash to FP. Subsequently, on Date C in Year 2, DS1 sells USS1 Note to FS for $200x.

(B) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when USS1 issues USS1 Note to DS1 for property on Date A in Year 1, the USS1 consolidated group is not treated as a funded member, and when USS1 distributes $200x to FP on Date B in Year 2, that distribution is a transaction described in §1.385-3(b)(3)(i)(A), but does not cause USS1 Note to be recharacterized under §1.385-3(b)(3). When DS1 sells USS1 Note to FS, USS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before USS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, when the USS1 Note is transferred to FS for $200x on Date C in Year 2, the USS1 consolidated group is treated as issuing USS1 Note to FS in exchange for $200x on that date. Because USS1 Note is issued by the USS1 consolidated group to FS within the per se period as defined in §1.385-3(g)(19) with respect to the distribution by the USS1 consolidated group to FS, USS1 Note is treated as funding the distribution under §1.385-3(b)(3)(i)(A) and, accordingly, is treated as stock under §1.385-3(b)(3). Under §1.385-3(d)(1)(i) and paragraph (c)(1)(i)(ii) of this section, USS1 Note is deemed to be exchanged for stock of the issuing member, USS1, immediately after USS1 Note is transferred outside of the USS1 consolidated group. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-13(g)(3)(ii) and the deemed issuance and exchange under paragraph (c)(1)(ii) of this section, are respected as separate steps and treated as separate transactions.

(iv) Example 4: Treatment of consolidated group debt instrument and departing member’s regarded distribution or acquisition when the issuer of the instrument leaves the consolidated group—(A) Facts. The facts are the same as provided in paragraph (f)(1) of this section, except that USS1 and FS own 90% and 10% of the stock of DS1, respectively. On Date A in Year 1, DS1 distributes $80x of cash and newly-issued DS1 Note, which has a value of $10x, to USS1. Also on Date A in Year 1, DS1 distributes $10x of cash to FS. On Date B in Year 2, FS purchases all of USS1’s stock in DS1 (90% of the stock of DS1), resulting in DS1 ceasing to be a member of the USS1 consolidated group.

(B) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, DS1’s distribution of $80x of cash to USS1 on Date A in Year 1 is a disregarded distribution or acquisition, and under paragraph (d)(1) of this section, continues to be a disregarded distribution or acquisition when DS1 ceases to be a member of the USS1 consolidated group. In addition, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to a member of DS1’s expanded group in a distribution for purposes of §1.385-3(b)(2), and DS1 Note is not treated as stock under §1.385-3. When USS1 distributes DS1 Note to FP, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, for purposes of §1.385-3, DS1 is treated as issuing a new debt instrument to USS1 in exchange for property immediately after DS1 Note ceases to be a consolidated group debt instrument. Under paragraph (d)(4)(ii) of this section, the departing member, DS1 (and not the USS1 consolidated group) is treated as having distributed $10x to FS on Date A in Year 1 (a disregarded distribution or acquisition) for purposes of applying §1.385-3(b)(3) after DS1 ceases to be a member of the USS1 consolidated group. Because DS1 Note is reissued by DS1 to USS1 within the per se period (as defined in §1.385-3(g)(19) with respect to DS1’s regarded distribution to FS, DS1 Note is treated as funding the distribution under §1.385-3(b)(3)(i)(A) and, accordingly, is treated as stock under §1.385-3(b)(3). Under §1.385-3(d)(1)(i) and paragraph (c)(1)(i)
of this section, DS1 Note is immediately deemed to be exchanged for stock of DS1 on Date B in Year 2. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-13(g)(3) (ii) and the deemed issuance and exchange under paragraph (c)(1)(ii) of this section are respected as separate steps and treated as separate transactions. Under §1.385-3(d)(7)(i), after DS1 Note is treated as stock held by USS1, DS1 Note is not treated as stock for purposes of determining whether DS1 is a member of the USS1 consolidated group.

(v) Example 5: Treatment of consolidated group debt instrument and consolidated group’s regarded distribution or acquisition—(A) Facts. On Date A in Year 1, DS1 issues DS1 Note to USS1. On Date B in Year 2, USS1 distributes $100x of cash to FP. On Date C in Year 3, USS1 sells all of its interest in DS1 to FS, resulting in DS1 ceasing to be a member of the USS1 consolidated group.

(B) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to a member of DS1’s expanded group in a distribution for purposes of §1.385-3(b)(2)(i), and DS1 Note is not treated as stock under §1.385-3(b)(2)(i). DS1’s issuance of DS1 Note to USS1 is also a disregarded distribution or acquisition, and under paragraph (d)(1) of this section, continues to be a disregarded distribution or acquisition when DS1 ceases to be a member of the USS1 consolidated group. The distribution of $100x cash by DS1 to USS1 on Date B in Year 2 is a regarded distribution or acquisition. When FS purchases all of the stock of DS1 from USS1 on Date C in Year 3 and DS1 ceases to be a member of the USS1 consolidated group, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, for purposes of §1.385-3, DS1 is treated as issuing a new debt instrument to USS1 in exchange for property immediately after DS1 Note ceases to be a consolidated group debt instrument. Under paragraph (d)(4)(ii) of this section, the USS1 consolidated group (and not DS1) is treated as having distributed $100x to FS on Date B in Year 2 (a regarded distribution or acquisition) for purposes of applying §1.385-3(b)(3) after DS1 ceases to be a member of the USS1 consolidated group. Because DS1 has not engaged in a regarded distribution or acquisition that would have been treated as funded by the reissuance of DS1 Note, the reissued DS1 Note is not treated as stock.

(vi) Example 6: Treatment of departing member’s issuance of a covered debt instrument—(A) Facts. On Date A in Year 1, FS lends $100x of cash to DS1 in exchange for DS1 Note. On Date B in Year 2, USS1 distributes $30x of cash to FS. On Date C in Year 2, USS1 sells all of its DS1 stock to FP, resulting in DS1 ceasing to be a member of the USS1 consolidated group.

(B) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, on Date A in Year 1, the USS1 consolidated group is treated as issuing DS1 Note to FS, and on Date B in Year 2, the USS1 consolidated group is treated as distributing $30x of cash to FP. Because DS1 Note is issued by the USS1 consolidated group to FS within the per se period as defined in §1.385-3(g)(19) with respect to the distribution by the USS1 consolidated group of $30x cash to FP, $30x of DS1 Note is treated as funding the distribution under §1.385-3(b)(3) (iii)(A), and, accordingly, is treated as stock on Date B in Year 2 under §1.385-3(b)(3) and §1.385-3(d)(1) (ii). Under paragraph (d)(3) of this section, DS1 (and not the USS1 consolidated group) is treated as the issuer of the remaining portion of DS1 Note for purposes of applying §1.385-3(b)(3) after DS1 ceases to be a member of the USS1 consolidated group.

(g) Applicability date. This section applies to taxable years for which the U.S. Federal income tax return is due, without extensions, after May 14, 2020. For taxable years ending on or after January 19, 2017, and for which the U.S. Federal income tax return is due, without extensions, on or before May 14, 2020, see §1.385-4T, as contained in 26 CFR in part 1 in effect on April 1, 2019. In the case of a taxable year that ends after October 13, 2019, and on or before May 14, 2020, a taxpayer may choose to apply this section to the portion of the taxable year that occurs after the expiration of §1.385-4T on October 13, 2019, provided that all members of the taxpayer’s expanded group apply this section in its entirety.

Sunita Lough
Deputy Commissioner for Services and Enforcement.

Approved: April 2, 2020

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

(Filed by the Office of the Federal Register on May 13, 2019, 8:45 a.m., and published in the issue of the Federal Register for May 14, 2019, 85 F.R. 28867).
Part III

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

Notice 2020-37

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

YIELD CURVE AND SEGMENT RATES

Section 430 specifies the minimum funding requirements that apply to single-employer plans (except for CSEC plans under § 414(y)) pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan’s target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates (“segment rates”), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins.1 However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates. Notice 2007-81, 2007-44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Consistent with the methodology specified in Notice 2007-81, the monthly corporate bond yield curve derived from April 2020 data is in Table 2020-4 at the end of this notice. The spot first, second, and third segment rates for the month of April 2020 are, respectively, 1.58, 2.88, and 3.24.

The 24-month average segment rates determined under § 430(h)(2)(C)(i) through (iii) must be adjusted pursuant to § 430(h)(2)(C)(iv) to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates. For plan years beginning before 2021, the applicable minimum percentage is 90% and the applicable maximum percentage is 110%. The 25-year average segment rates for plan years beginning in 2019 and 2020 were published in Notice 2018-73, 2018-40 I.R.B. 526, and Notice 2019-51, 2019-41 I.R.B. 866, respectively.

24-MONTH AVERAGE CORPORATE BOND SEGMENT RATES

The three 24-month average corporate bond segment rates applicable for May 2020 without adjustment for the 25-year average segment rate limits are as follows:

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<tr>
<th>Applicable Month</th>
<th>First Segment</th>
<th>Second Segment</th>
<th>Third Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2020</td>
<td>2.62</td>
<td>3.66</td>
<td>4.14</td>
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</table>

Based on § 430(h)(2)(C)(iv), the 24-month averages applicable for May 2020, adjusted to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates, are as follows:

<table>
<thead>
<tr>
<th>For Plan Years Beginning In</th>
<th>Applicable Month</th>
<th>First Segment</th>
<th>Second Segment</th>
<th>Third Segment</th>
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<tr>
<td>2019</td>
<td>May 2020</td>
<td>3.74</td>
<td>5.35</td>
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<tr>
<td>2020</td>
<td>May 2020</td>
<td>3.64</td>
<td>5.21</td>
<td>5.94</td>
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</tbody>
</table>

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 431 specifies the minimum funding requirements that apply to multi-employer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in § 431(c)(6)(A), based on the plan’s current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treas-

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1 Pursuant to § 433(h)(3)(A), the 3rd segment rate determined under § 430(h)(2)(C) is used to determine the current liability of a CSEC plan (which is used to calculate the minimum amount of the full funding limitation under § 433(c)(7)(C)).
sury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88-73, 1988-2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for April 2020 is 1.27 percent. The Service determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in February 2050. For plan years beginning in May 2020, the weighted average of the rates of interest on 30-year Treasury securities and the permissible range of rates used to calculate current liability are as follows:

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<th>Treasury Weighted Average Rates</th>
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<td>For Plan Years Beginning In</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>May 2020</td>
</tr>
<tr>
<td>30-Year Treasury Weighted Average</td>
</tr>
<tr>
<td>2.64</td>
</tr>
<tr>
<td>Permissible Range</td>
</tr>
<tr>
<td>90% to 105%</td>
</tr>
<tr>
<td>2.38 to 2.78</td>
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</tbody>
</table>

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007-81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value segment rates determined for April 2020 are as follows:

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<thead>
<tr>
<th>Minimum Present Value Segment Rates</th>
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<tbody>
<tr>
<td>Month</td>
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<tr>
<td>First Segment</td>
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<td>Second Segment</td>
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<td>Third Segment</td>
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<tr>
<td>April 2020</td>
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<tr>
<td>1.58</td>
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<tr>
<td>2.88</td>
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<td>3.24</td>
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DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the IRS participated in the development of this guidance. For further information regarding this notice, contact Mr. Morgan at 202-317-6700 or Paul Stern at 202-317-8702 (not toll-free calls).
Table 2020–4  
Monthly Yield Curve for April 2020  
Derived from April 2020 Data

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<th>Maturity</th>
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Bulletin No. 2020–23 903

Credit for Renewable Electricity Production, Refined Coal Production, and Indian Coal Production, and Publication of Inflation Adjustment Factors and Reference Prices for Calendar Year 2020

Notice 2020-38

This notice publishes the inflation adjustment factors and reference prices for calendar year 2020 for the renewable electricity production credit, the refined coal production credit, and the Indian coal production credit under section 45 of the Internal Revenue Code. The 2020 inflation adjustment factors and reference prices are used in determining the availability of the credits and apply to calendar year 2020 sales of kilowatt hours of electricity produced in the United States or a possession thereof from qualified energy resources, and to calendar year 2020 sales of refined coal and Indian coal produced in the United States or a possession thereof.

BACKGROUND

Section 45(a) provides that the renewable electricity production credit for any tax year is an amount equal to the product of 1.5 cents multiplied by the kilowatt hours of specified electricity produced by the taxpayer and sold to an unrelated person during the tax year. This electricity must be produced from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service.

Section 45(b)(1) provides that the amount of the credit determined under section 45(a) is reduced by an amount which bears the same ratio to the amount of the credit as (A) the amount by which the reference price for the calendar year in which the sale occurs exceeds 8 cents, bears to (B) 3 cents. Under section 45(b)(2), the 1.5 cent amount in section 45(a), the 8 cent amount in section 45(b)(1), the $4.375 amount in section 45(c)(8)(A), and, in section 45(e)(8)(B)(i), the reference price of fuel used as feedstock (within the meaning of section 45(c)(7)(A)) in 2002, are each adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1 cent, the amount is rounded to the nearest multiple of 0.1 cent. In the case of electricity produced in open-loop biomass facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities, section 45(b)(4)(A) requires the amount in effect under section 45(a)(1) (before rounding to the nearest 0.1 cent) to be reduced by one-half.

Section 45(b)(5) provides that in the case of any facility using wind to produce electricity, the amount of the credit determined under section 45(a) (determined after the application of section 45(b)(1), (2), and (3) and without regard to section 45(b)(5)) shall be reduced by (A) in the case of any facility the construction of which begins after December 31, 2016, and before January 1, 2018, 20 percent, (B) in the case of any facility the construction the construction of which begins after December 31, 2017, and before January 1, 2019, 40 percent, (C) in the case of any facility the construction of which begins after December 31, 2018, and before January 1, 2020, 60 percent, and (D) in the case of any facility the construction of which begins after December 31, 2019, and before January 1, 2021, 40 percent.

Section 45(c)(1) defines qualified energy resources as wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy.

Section 45(d)(1) defines a qualified facility using wind to produce electricity as any facility owned by the taxpayer that is originally placed in service after December 31, 1992, and the construction of which begins before January 1, 2021, or (ii) owned by the taxpayer which before January 1, 2021 is originally placed in service and modified to use closed-loop biomass to co-fire with coal, with other biomass, or with both, but only if the modification is approved under the Biomass Power for Rural Development Programs or is part of a pilot project of the Commodity Credit Corporation as described in 65 FR 63052. For purposes of section 45(d)(2)(A)(ii), a facility shall be treated as modified before January 1, 2021, if the construction of such modification begins before such date. Section 45(d)(2)(C) provides that in the case of a qualified facility described in section 45(d)(2)(A)(ii), (i) the 10-year period referred to in section 45(a) is treated as beginning no earlier than the date of the enactment of section 45(d)(2)(C)(i) (October 22, 2004), and (ii) if the owner of such facility is not the producer of the electricity, the person eligible for the credit allowable under section 45(a) is the lessee or the operator of such facility. A qualified facility using closed-loop biomass includes a new unit placed in service after the date of the enactment of section 45(d)(2)(B) (October 3, 2008) in connection with a qualified facility using closed-loop biomass, but only to the extent of the increased amount of electricity produced at the facility by reason of such new unit.

Section 45(d)(3)(A) defines a qualified facility using open-loop biomass to produce electricity as any facility owned by the taxpayer which (i) in the case of a facility using agricultural livestock waste nutrients, (I) is originally placed in service after the date of the enactment of section 45(d)(3)(A)(i)(I) (October 22, 2004) and the construction of which begins before January 1, 2021, and (II) the nameplate capacity rating of which is not less than 150 kilowatts, and (ii) in the case of any other facility, the construction of which begins before January 1, 2021. In the case of any facility described in section 45(d)(3)(A), if the owner of such facility is not the producer of the electricity, section 45(d)(3)(C) provides that the person eligible for the credit allowable under section 45(a) is the lessee or the operator of such facility. A qualified facility using open-loop biomass includes a new unit placed in service after the date of the enactment
of section 45(d)(3)(B) (October 3, 2008) in connection with a qualified facility using open-loop biomass, but only to the extent of the increased amount of electricity produced at the facility by reason of such new unit.

Section 45(d)(4) defines a qualified facility using geothermal energy to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of the enactment of section 45(d)(4) (October 22, 2004) and the construction of which begins before January 1, 2021. A qualified facility using geothermal energy does not include any property described in section 48(a)(3) the basis of which is taken into account by the taxpayer for purposes of determining the energy credit under section 48.

Section 45(d)(6) defines a qualified facility using gas derived from the biodegradation of municipal solid waste to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of the enactment of section 45(d)(6) (October 22, 2004) and the construction of which begins before January 1, 2021. A qualified facility using municipal solid waste includes a new unit placed in service in connection with a facility placed in service on or before the date of the enactment of section 45(d)(7), but only to the extent of the increased amount of electricity produced at the facility by reason of such new unit.

Section 45(d)(7) defines a qualified facility that produces refined coal (other than a facility described in section 45(d)(6)) that uses municipal solid waste to produce electricity as any facility owned by the taxpayer which is originally placed in service after the date of the enactment of section 45(d)(7) (October 22, 2004) and the construction of which begins before January 1, 2021. A qualified facility using municipal solid waste includes a new unit placed in service in connection with a facility placed in service on or before the date of the enactment of section 45(d)(7), but only to the extent of the increased amount of electricity produced at the facility by reason of such new unit.

Section 45(d)(8) provides, in the case of a facility producing electricity from marine and hydrokinetic renewable energy, the term "qualified facility" means any facility producing refined coal placed in service after the date of the enactment of the American Jobs Creation Act of 2004 (October 22, 2004) before January 1, 2012.

Section 45(d)(9) defines a qualified facility producing qualified hydroelectric production described in section 45(c)(8) as (i) any facility producing incremental hydropower production, but only to the extent of its incremental hydropower production attributable to efficiency improvements or additions to capacity described in section 45(c)(8)(B) placed in service after the date of the enactment of section 45(d)(9)(A)(i) (August 8, 2005) and before January 1, 2021, and (ii) any other facility placed in service after the date of the enactment of section 45(d)(9)(A)(ii) (August 8, 2005) and the construction of which begins before January 1, 2021. Section 45(d)(9)(B) provides that, in the case of a qualified facility described in section 45(d)(9)(A), the 10-year period referred to in section 45(a) shall be treated as beginning on the date the efficiency improvements or additions to capacity are placed in service. Section 45(d)(9)(C) provides that for purposes of section 45(d)(9)(A) (i), an efficiency improvement or addition to capacity shall be treated as placed in service before January 1, 2021 if the construction of such improvement or addition begins before such date.

Section 45(d)(10) provides that the term "Indian Coal Production Facility" means a facility that produces Indian coal. Section 45(d)(11) provides in the case of a facility producing electricity from marine and hydrokinetic renewable energy, the term "qualified facility" means any facility owned by the taxpayer which (A) has a nameplate capacity rating of at least 150 kilowatts, and (B) is originally placed in service on or after the date of the enactment of section 45(d)(11)(B) (October 3, 2008) and the construction of which begins before January 1, 2021.

Section 45(e)(8)(A) provides that the refined coal production credit is an amount equal to $4.375 per ton of qualified refined coal (i) produced by the taxpayer at a refined coal production facility during the 10-year period beginning on the date the facility was originally placed in service, and (ii) sold by the taxpayer (I) to an unrelated person and (II) during such 10-year period beginning before January 1, 2021, and (ii) any other facility placed in service after the date of the enactment of section 45(d)(9)(A)(ii) (August 8, 2005) and the construction of which begins before January 1, 2021. Section 45(d)(9)(B) provides that, in the case of a qualified facility described in section 45(d)(9)(A), the 10-year period referred to in section 45(a) shall be treated as beginning on the date the efficiency improvements or additions to capacity are placed in service. Section 45(d)(9)(C) provides that for purposes of section 45(d)(9)(A) (i), an efficiency improvement or addition to capacity shall be treated as placed in service before January 1, 2021 if the construction of such improvement or addition begins before such date.

Section 45(d)(10) provides that the term "Indian Coal Production Facility" means a facility that produces Indian coal. Section 45(d)(11) provides in the case of a facility producing electricity from marine and hydrokinetic renewable energy, the term "qualified facility" means any facility owned by the taxpayer which (A) has a nameplate capacity rating of at least 150 kilowatts, and (B) is originally placed in service on or after the date of the enactment of section 45(d)(11)(B) (October 3, 2008) and the construction of which begins before January 1, 2021.

Section 45(e)(8)(A) provides that the refined coal production credit is an amount equal to $4.375 per ton of qualified refined coal (i) produced by the taxpayer at a refined coal production facility during the 10-year period beginning on the date the facility was originally placed in service, and (ii) sold by the taxpayer (I) to an unrelated person and (II) during such 10-year period and the tax year. Section 45(e)(8)(B) provides that the amount of credit determined under section 45(e)(8)(A) is reduced by an amount which bears the same ratio to the amount of the increase as (i) the amount by which the reference price of fuel used as feedstock (within the meaning of section 45(c)(7)(A)) for the calendar year in which the sale occurs exceeds an amount equal to 1.7 multiplied by the reference price for such fuel in 2002, bears to (ii) $8.75.

Section 45(e)(10)(A) provides in the case of a producer of Indian coal, the credit determined under section 45 for any taxable year is an amount equal to the applicable dollar amount per ton of Indian coal (i) produced by the taxpayer at an Indian coal production facility during the 15-year period beginning on January 1, 2006, and (ii) sold by the taxpayer (I) to an unrelated person, and (II) during such 15-year period and such taxable year.

Section 45(e)(10)(B)(i) defines "applicable dollar amount" for any taxable year as (I) $1.50 in the case of the calendar years 2006 through 2009, and (II) $2.00 in the case of calendar years beginning after 2009.

Section 45(e)(2)(A) requires the Secretary to determine and publish in the Federal Register each calendar year the inflation adjustment factors and the reference prices for such calendar year. The inflation adjustment factors and the reference prices for the 2020 calendar year were published in the Federal Register at 85 FR 28698 on May 13, 2020.

Section 45(e)(2)(B) defines the inflation adjustment factor for a calendar year as a fraction the numerator of which is the GDP implicit price deflator for the preceding calendar year and the denominator of which is the GDP implicit price deflator for the calendar year 1992. The term "GDP implicit price deflator" means the most recent revision of the implicit price deflator for the gross domestic product as computed and published by the Department of Commerce before March 15 of the calendar year.

Under section 45(e)(10)(B)(ii), in the case of any calendar year after 2006, each of the dollar amounts under section 45(e)(10)(B)(i) shall be equal to the product of such dollar amount and the inflation adjustment factor determined under section 45(e)(2)(B) for the calendar year, except that section 45(e)(2)(B) shall be applied by substituting 2005 for 1992.

Section 45(e)(2)(C) provides that the reference price is the Secretary’s determination of the annual average contract price per kilowatt hour of electricity generated from the same qualified energy resource and sold in the previous year in the United

June 1, 2020 904 Bulletin No. 2020–23
States. Only contracts entered into after December 31, 1989 are taken into account.

Under section 45(e)(8)(C), the determination of the reference price for fuel used as feedstock within the meaning of section 45(c)(7)(A) is made according to rules similar to the rules under section 45(e)(2)(C).

INFLATION ADJUSTMENT FACTORS AND REFERENCE PRICES

The inflation adjustment factor for calendar year 2020 for qualified energy resources and refined coal is 1.6687. The inflation adjustment factor for calendar year 2020 for Indian coal is 1.2851.

The reference price for calendar year 2020 for facilities producing electricity from wind (based upon information provided by the Department of Energy) is 4.16 cents per kilowatt hour. The reference prices for fuel used as feedstock within the meaning of section 45(c)(7)(A), relating to refined coal production (based upon information provided by the Department of Energy) are $31.90 per ton for calendar year 2002 and $48.58 per ton for calendar year 2020. The reference prices for facilities producing electricity from closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, and marine and hydrokinetic energy have not been determined for calendar year 2020.

PHASEOUT CALCULATION

Because the 2020 reference price for electricity produced from wind (4.16 cents per kilowatt hour) does not exceed 8 cents multiplied by the inflation adjustment factor (1.6687), the phaseout of the credit provided in section 45(b)(1) does not apply to such electricity sold during calendar year 2020. However, refer to section 45(b)(5) for an additional phaseout of the credit for wind facilities the construction of which begins after December 31, 2016. Because the 2020 reference price of fuel used as feedstock for refined coal ($48.58) does not exceed $90.49 (which is the $31.90 reference price of such fuel in 2002 multiplied by the inflation adjustment factor (1.6687) and 1.7), the phaseout of the credit provided in section 45(e)(8)(B) does not apply to refined coal sold during calendar year 2020. Further, for electricity produced from closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, and marine and hydrokinetic energy, the phaseout of the credit provided in section 45(b)(1) does not apply to such electricity sold during calendar year 2020.

CREDIT AMOUNT BY QUALIFIED ENERGY RESOURCE AND FACILITY, REFINED COAL, AND INDIAN COAL

As required by section 45(b)(2), the 1.5 cent amount in section 45(a)(1), and the $4.375 amount in section 45(e)(8)(A) are each adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1 cent, such amount is rounded to the nearest multiple of 0.1 cent. In the case of electricity produced in open-loop biomass facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic renewable energy facilities, section 45(b)(4)(A) requires the amount in effect under section 45(a)(1) (before rounding to the nearest 0.1 cent) to be reduced by one-half. Under the calculation required by section 45(b)(2), the credit for renewable electricity production for calendar year 2020 under section 45(a) is 2.5 cents per kilowatt hour on the sale of electricity produced from the qualified energy resources of wind, closed-loop biomass, and geothermal energy, and 1.3 cents per kilowatt hour on the sale of electricity produced in open-loop biomass facilities, landfill gas facilities, trash facilities, qualified hydropower facilities, and marine and hydrokinetic energy facilities.

Under the calculation required by section 45(b)(2), the credit for refined coal production for calendar year 2020 under section 45(e)(8)(A) is $7.301 per ton on the sale of qualified refined coal.

As required by section 45(e)(10)(B) (ii), the $2.00 amount in section 45(e)(10)(B)(i) is adjusted by multiplying such amount by the inflation adjustment factor for the calendar year. Under the calculation required by section 45(e)(10)(B)(ii), the credit for Indian coal production for calendar year 2020 under section 45(e)(10)(B) is $2.570 per ton on the sale of Indian coal.

DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Charles Hyde of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Mr. Hyde at (202) 317-6853 (not a toll-free number).

Implementation of Nonresident Alien Deposit Interest Regulations

Rev. Proc. 2020-15

SECTION 1. PURPOSE

This revenue procedure provides a list of the jurisdictions with which the United States has in effect a relevant information exchange agreement such that the reporting requirement of §§ 1.6049-4(b)(5) and 1.6049-8(a) of the Income Tax Regulations may apply with respect to certain deposit interest paid to residents of such jurisdictions.

This revenue procedure also provides a list of the jurisdictions with which the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) have determined that it is appropriate to have an automatic exchange relationship with respect to the information collected under §§ 1.6049-4(b)(5) and 1.6049-8(a).

These lists are updated and restated versions of those set forth in Rev. Proc. 2019-23, 2019-38 I.R.B. 725. Singapore has been added to the list of jurisdictions with which the United States has in effect a relevant information exchange agreement.
SECTION 2. BACKGROUND

Sections 1.6049-4(b)(5) and 1.6049-8(a), as revised by TD 9584, 2012-20 I.R.B. 900, require the reporting of certain deposit interest paid to nonresident alien individuals on or after January 1, 2013. Section 1.6049-4(b)(5) provides that in the case of interest aggregating $10 or more paid to a nonresident alien individual (as defined in section 7701(b)(1)(B)) that is reportable under § 1.6049-8(a), the payor is required to make an information return on Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding, for the calendar year in which the interest is paid.

Interest that is reportable under § 1.6049-8(a) is interest described in section 871(i)(2)(A) that relates to a deposit maintained at an office within the United States. The regulations also provide that such deposit interest is reportable only if paid to a resident of a jurisdiction that is identified as a jurisdiction with which the United States has in effect an income tax or other convention or bilateral agreement relating to the exchange of tax information within the meaning of section 6103(k)(4), under which the competent authority is the Secretary of the Treasury or his delegate and the United States agrees to provide, as well as receive, information. Finally, the regulations provide that jurisdictions are so identified in an applicable revenue procedure (see § 601.601(d)(2)) as of December 31 before the calendar year in which the interest is paid. The preamble to the regulations (at 2012-20 I.R.B. 901-02) notes that the IRS will not exchange information with another jurisdiction, even if an information exchange agreement is in effect, if there are concerns about confidentiality, safeguarding of data exchanged, the use of the information, or other factors that would make the exchange of information inappropriate.

Rev. Proc. 2012-24, 2012-20 I.R.B. 913, was published contemporaneously with the publication of TD 9584 to provide a list of those jurisdictions with which the United States has in effect an income tax or other convention or bilateral agreement relating to the exchange of tax information within the meaning of section 6103(k)(4) pursuant to which the United States agrees to provide, as well as receive, information and under which the competent authority is the Secretary of the Treasury or his delegate:

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Rev. Proc. First Identifying Jurisdiction</th>
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<tr>
<td>Antigua &amp; Barbuda</td>
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<td>Argentina</td>
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SECTION 3. JURISDICTIONS OF RESIDENCE WITH RESPECT TO WHICH THE DEPOSIT INTEREST REPORTING REQUIREMENT APPLIES

The following are the jurisdictions with which the United States has in effect an income tax or other convention or bilateral agreement relating to the exchange of tax information within the meaning of section 6103(k)(4) pursuant to which the United States agrees to provide, as well as receive, information and under which the competent authority is the Secretary of the Treasury or his delegate:
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<tr>
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SECTION 4. JURISDICTIONS WITH WHICH THE TREASURY DEPARTMENT AND THE IRS HAVE DETERMINED THAT AUTOMATIC EXCHANGE OF DEPOSIT INTEREST INFORMATION IS APPROPRIATE

The following list identifies the jurisdictions with which the automatic exchange of the information collected under §§ 1.6049-4(b)(5) and 1.6049-8 has been determined by the Treasury Department and the IRS to be appropriate:

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<th>Jurisdiction</th>
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<tr>
<td>United Kingdom</td>
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SECTION 5. EFFECT ON OTHER DOCUMENTS


SECTION 6. EFFECTIVE DATES

For purposes of the reporting requirement of § 1.6049-4(b)(5), the list of jurisdictions in Section 3 of this revenue procedure is effective: (i) with respect to Singapore, for interest paid on or after January 1, 2021; and (ii) with respect to each other listed jurisdiction, for interest paid on or after January 1 of the calendar year following the issuance of the revenue procedure (as cited in Section 3) first identifying the jurisdiction as having in effect an agreement with the United States as described in § 1.6049-8(a).

The list of jurisdictions in Section 4 of this revenue procedure is effective from the date of issuance of this revenue procedure with respect to information reported to the IRS pursuant to §§ 1.6049-4(b)(5) and 1.6049-8(a) for any tax year for which the jurisdiction was included in the list in Section 3. The revenue procedure citations in the Section 4 list are included for historical reference.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Jackie Bennett Manasterli of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Ms. Manasterli at (202) 317-6941 (not a toll-free number).
Part IV

Announcement related to income tax treaty references to the NAFTA in light of its pending replacement by the USMCA

Announcement 2020-6

Since January 1, 1994, the North American Free Trade Agreement (the “NAFTA”) has governed trade relations between the United States, Mexico, and Canada. On November 30, 2018, the Governments of the United States, Mexico, and Canada signed the Protocol Replacing the North American Free Trade Agreement with the Agreement between the United States of America, the United Mexican States, and Canada (the “Agreement”). The Agreement was amended by a Protocol signed on December 10, 2019 (the “Protocol of Amendment” and, collectively with the Agreement, the “USMCA”). The USMCA, upon its entry into force, will supersede the NAFTA. The USMCA sets forth modernized standards for trade and investment among the three countries going forward.

Most U.S. bilateral income tax treaties contain Limitation on Benefits (“LOB”) articles, which set forth provisions designed to prevent entities resident in a treaty jurisdiction from inappropriately accessing tax treaty benefits. Most LOB articles in U.S. bilateral income tax treaties provide a series of objective tests pursuant to which a resident may qualify for a treaty benefit provided such resident meets all other requirements specified in the treaty for claiming the benefit. A number of these LOB tests contain explicit references to the NAFTA. For example, under Article 28(3) of the U.S.-Germany Income Tax Treaty, otherwise known as the “derivative benefits” test, a resident company not otherwise entitled to benefits may claim treaty benefits if its principal class of shares is primarily traded on a recognized stock exchange located in the United States or another country that is a party to the NAFTA.

Upon the USMCA’s entering into force, for purposes of applying an applicable U.S. income tax treaty, the Department of the Treasury (“Treasury Department”) and the Internal Revenue Service (“IRS”), including the U.S. Competent Authority, believe that any reference to the NAFTA in a U.S. bilateral income tax treaty should be interpreted as a reference to the USMCA. The USMCA modernizes and replaces the NAFTA, is entered into by the same parties, and governs the terms of trade among those parties.

The Treasury Department and the IRS will reach out to countries that have an applicable tax treaty containing references to the NAFTA to confirm that they agree with this interpretation.

The principal author of this announcement is Richard F. Owens of the Office of Associate Chief Counsel (International). For further information regarding this announcement contact Richard F. Owens at (202) 317-6501 (not a toll-free number).

Notice of Proposed Rulemaking

Denial of Deduction for Certain Fines, Penalties, and Other Amounts; Information With Respect To Certain Fines, Penalties, and Other Amounts

REG-104591-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance on section 162(f) of the Internal Revenue Code (Code), as amended by legislation enacted in 2017, concerning the deduction of certain fines, penalties, and other amounts. This document also contains proposed regulations that provide guidance relating to the information reporting requirements under new section 6050X of the Code with respect to those fines, penalties, and other amounts. The proposed regulations affect taxpayers that pay or incur amounts to, or at the direction of, governments, governmental entities or certain nongovernmental entities treated as governmental entities (nongovernmental entities) in relation to the violation of a law or investigations or inquiries by such governments, governmental entities, or nongovernmental entities into the potential violation of a law. The proposed regulations also affect governments, governmental entities, and nongovernmental entities subject to the related reporting requirement.

DATES: Written or electronic comments and requests for a public hearing must be received by July 13, 2020. Requests for a public hearing must be submitted as prescribed in the “Comments and Requests for a Public Hearing” section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-104591-18) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submit-
deduction for fines or similar penalties be ordinary and necessary business expense codified existing case law that denied an deduction, under section 162(a), for any fine or similar penalty paid to a government for the violation of a law. This provision codified existing case law that denied an ordinary and necessary business expense deduction for fines or similar penalties because “allowance of the deduction would frustrate sharply defined national or State policies proscribing the particular types of conduct evidenced by some governmental declaration thereof.” See S. Rep. No. 552-91 at 273 - 274 (1969). On February 20, 1975, the Treasury Department and the IRS issued final regulations concerning prior law under section 162(f) (TD 7345, 40 FR 7437) (1975 regulations). See §1.162-21. Amendments were published on July 11, 1975 (T.D. 7366, 40 FR 29290). Section 1.162-21(a) of the 1975 regulations describe the term “paid to” a government. Section 1.162-21(b)(1) of the 1975 regulations describes certain amounts that constitute fines or similar penalties; §1.162-21(b)(2) provides that compensatory damages paid to a government do not constitute a fine or penalty. Section 1.162-21(c) provides examples to illustrate the application of the 1975 regulations.

As amended by section 13306(a)(1) of the TCJA, the general rule of section 162(f)(1) provides that no deduction otherwise allowable under chapter 1 of the Code (chapter 1) shall be allowed for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government, governmental entity, or nongovernmental entity in relation to the violation, or investigation or inquiry into the potential violation, of a law under section 162(f), as amended by section 13306(a) of Public Law No. 115-97, 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). The proposed additions implement the reporting requirements, under section 6050X, added to the Code by section 13306(b) of the TCJA.

Prior law under section 162(f) was enacted in 1969. Public Law No. 91-172, 83 Stat. 487 (1969). Unless certain exceptions applied, prior law under section 162(f) disallowed an ordinary and necessary deduction, under section 162(a), for any fine or similar penalty paid to a government for the violation of a law. This provision codified existing case law that denied an ordinary and necessary business expense deduction for fines or similar penalties because “allowance of the deduction would frustrate sharply defined national or State policies proscribing the particular types of conduct evidenced by some governmental declaration thereof.” See S. Rep. No. 552-91 at 273 - 274 (1969). On February 20, 1975, the Treasury Department and the IRS issued final regulations concerning prior law under section 162(f) (TD 7345, 40 FR 7437) (1975 regulations). See §1.162-21. Amendments were published on July 11, 1975 (T.D. 7366, 40 FR 29290). Section 1.162-21(a) of the 1975 regulations describe the term “paid to” a government. Section 1.162-21(b)(1) of the 1975 regulations describes certain amounts that constitute fines or similar penalties; §1.162-21(b)(2) provides that compensatory damages paid to a government do not constitute a fine or penalty. Section 1.162-21(c) provides examples to illustrate the application of the 1975 regulations.

As amended by section 13306(a)(1) of the TCJA, the general rule of section 162(f)(1) provides that no deduction otherwise allowable under chapter 1 of the Code (chapter 1) shall be allowed for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government, governmental entity, or nongovernmental entity in relation to the violation of a law or the investigation or inquiry by such government or governmental entity into the potential violation of a law.

Section 162(f)(5) describes certain self-regulating nongovernmental entities treated as governmental entities. Because section 162(f)(5) treats these nongovernmental entities as governmental entities, exclusively for purposes of section 162(f) and the related provisions of section 6050X, the term “governmental entities” includes those nongovernmental entities treated as governmental entities.

Section 162(f)(2) provides an exception to the general rule and allows a taxpayer to deduct certain amounts paid or incurred that are otherwise allowable under chapter 1 for restitution, remediation, or paid to come into compliance with a law. Section 162(f)(3) provides an exception to the general rule for amounts paid or incurred with respect to private party suits; section 162(f)(4) provides an exception for certain taxes due.

Under section 162(f)(2)(A)(i) and (ii), section 162(f)(1) shall not disallow a deduction for amounts that (i) the taxpayer establishes were paid or incurred as restitution (including remediation of property) or to come into compliance with a law (establishment requirement), and (ii) are identified in the court order (order) or settlement agreement (agreement) as restitution, remediation, or amounts paid or incurred to come into compliance with a law (identification requirement).

The extent to which the amount paid would otherwise be deductible under chapter 1, section 162(f)(2)(A)(iii), (f)(3), and (f)(4) provide that section 162(f)(1) shall not disallow a deduction for amounts paid or incurred as reimbursement to a government or governmental entity for the costs of any investigation or litigation.

The phone numbers above may also be reached by individuals who are deaf or hard of hearing, or who have speech disabilities, through the Federal Relay Service toll-free at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed revisions to 26 CFR part 1 under section 162(f) and proposed additions to 26 CFR part 1 under section 6050X. The proposed revisions implement the disallowance of deductions for amounts paid or incurred to, or at the direction of, a government, governmental entity, or nongovernmental entity in relation to the violation, or investigation or inquiry into the potential violation, of a law under section 162(f), as amended by section 13306(a) of Public Law No. 115-97, 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). The proposed additions implement the reporting requirements, under section 6050X, added to the Code by section 13306(b) of the TCJA.
was violated or involved in the investigation or inquiry.

Section 6050X(a)(3) provides that the government or governmental entity shall file the information return at the time the agreement is entered into, as determined by the Secretary. Section 6050X(b) requires the government or governmental entity to furnish to each person who is a party to the suit, agreement, or otherwise a written statement, at the time the information return is filed with the IRS, that includes (1) the name of the government or entity and (2) the information submitted to the IRS.

Under section 13306(a)(2) and (b)(3) of the TCJA, the amendments to section 162(f) and new section 6050X apply to amounts paid or incurred on or after the date of the enactment of the TCJA (December 22, 2017). However, they do not apply to amounts paid or incurred under any binding order or agreement entered into before December 22, 2017 and, if such order or agreement requires court approval, the required approval is obtained before December 22, 2017.

On April 9, 2018, the IRS published Notice 2018-23, 2018-15 I.R.B. 474, to provide transitional guidance on the identification requirement of section 162(f)(2)(A)(ii) and the information reporting requirement under section 6050X. Notice 2018-23 provides that information reporting is not required until the date specified in proposed regulations under section 6050X. Notice 2018-23 also provides that, until the Treasury Department and the IRS issue proposed regulations, the identification requirement is treated as satisfied if the order or agreement specifically states on its face that an amount is paid or incurred as restitution, remediation, or to come into compliance with a law.

Under these proposed regulations, the identification requirement applies to taxable years beginning on or after the date the proposed regulations are adopted as final regulations. Until that date, taxpayers, governments, and governmental entities may rely on the proposed regulations.

**Explanation of Provisions**

1. *Denial of Deduction for Certain Fines, Penalties, and Other Amounts*

The proposed regulations revise §1.162-21 and provide operational and definitional guidance concerning the application of section 162(f), as amended by the TCJA. The terms used in section 162(f), and throughout these proposed regulations, are defined in proposed §1.162-21(f) and discussed in this section. In addition, this section describes the exceptions to the general rule of section 162(f)(1). Proposed §1.162-21(g) provides examples for the application of this section.

**A. General rule**

Proposed §1.162-21(a) provides that a taxpayer may not take a deduction under any provision of chapter 1 (see section 161, and the related regulations, concerning items allowed as deductions) for amounts (1) paid or incurred by suit, agreement, or otherwise; (2) to, or at the direction of, a government or governmental entity; (3) in relation to the violation, or investigation or inquiry into the potential violation, of any civil or criminal law. This general rule applies regardless of whether the taxpayer admits guilt or liability or pays the amount imposed for any other reason, including to avoid the expense or uncertain outcome of an investigation or litigation.

Proposed §1.162-21(b) describes an exception to the general rule, which allows a deduction for certain amounts identified in the order or agreement as restitution, remediation, or paid or incurred to come into compliance with a law and the taxpayer establishes that the amount was paid or incurred for the purpose identified.

In general, section 6050X imposes a reporting requirement on governments and governmental entities with respect to the payment amount identified pursuant to certain suits, agreements, or otherwise. Proposed §1.6050X-1 provides rules for complying with the reporting requirement.

Under sections 162(f) and 6050X and proposed §§1.162-21 and 1.6050X-1, suit, agreement, or otherwise includes, but is not limited to, settlement agreements; non-prosecution agreements; deferred prosecution agreements; judicial proceedings; administrative adjudications; decisions issued by officials, committees, commissions, or boards of a government or governmental entity; and any legal actions or hearings in which a liability for the taxpayer is determined or pursuant to which the taxpayer assumes liability.

**B. Definitions**

Proposed §1.162-21(f) provides definitions relating to section 162(f).

**Government, governmental entity, or nongovernmental entity treated as a governmental entity**

The definition of “government or governmental entity” under proposed §1.162-21(f)(1) reflects the term “paid to” a government as described in the 1975 regulations but uses the term “territory” instead of “possession” and “Commonwealth” and includes additional territories. The definition of government or governmental entity under proposed §1.162-21(f)(1) also includes (1) the government of a federally recognized Indian tribal government or a subdivision of an Indian tribal government; (2) a political subdivision of, or corporation or other entity serving as an agency or instrumentality of, any government; or (3) a nongovernmental entity treated as a governmental entity. Under proposed §1.162-21(f)(2)(i), certain nongovernmental entities are treated as governmental entities.

Proposed §1.162-21(f)(2)(ii) adopts the definition of a nongovernmental entity in section 162(f)(5) in its entirety. Proposed §1.162-21(f)(2)(ii) provides that a nongovernmental entity is treated as a governmental entity if it (1) exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)); or (2) exercises self-regulatory powers, including adopting, administering, or enforcing laws and imposing sanctions, as part of performing an essential governmental function. Although nongovernmental entities are not governmental entities, for purposes of
proposed §§1.162-21 and 1.6050X-1 only, the term “governmental entities” includes the nongovernmental entities treated as governmental entities.

Restitution and remediation

Under proposed §1.162-21(f)(3)(i), an amount is paid or incurred for restitution or remediation if it restores, in whole or in part, the person, as defined in section 7701(a)(1); the government; the governmental entity; or property harmed by the violation or potential violation of a law. In response to Notice 2018-23, commentators disagreed about whether restitution, for purposes of section 162(f), includes forfeiture and disgorgement.

Forfeiture and disgorgement focus on the unjust enrichment of the wrongdoer, not the harm to the victim. In Kokesh v. Securities and Exchange Commission, 137 S. Ct. 1635, 1643 (2017), the Supreme Court held that disgorgement, when imposed as a sanction for violating a Federal securities law, was treated as a penalty of limitations because “[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains.” In Nacchio v. United States, 824 F.3d 1370 (Fed. Cir. 2016), cert. denied, 137 S. Ct. 2239 (2017), the United States Court of Appeals for the Federal Circuit noted that, “[w]hile restitution seeks to make victims whole by reimbursing them for their losses, forfeiture is meant to punish the defendant by transferring his ill-gotten gains to the United States Department of Justice.” Nacchio, 824 F.3d at 1378 (citing United States v. Joseph, 743 F.3d 1350, 1354 (11th Cir. 2014)).

Section 162(f)(2)(A)(i)(I) provides that restitution and remediation payments relate to the damage or harm caused, or that may be caused, by the violation, or the potential violation, of a law. The statute does not characterize restitution or remediation in connection with an unjust enrichment to a wrongdoer. Consistent with the statutory language, proposed §1.162-21(f)(3)(i) provides that the purpose of restitution or remediation is to restore the person or property, in whole or in part, to the same or substantially similar position or condition as before the harm caused by the taxpayer’s violation, or potential violation, of a law. Hence, under proposed §1.162-21(f)(3)(ii)(B)-(C), restitution, remediation, and amounts paid to come into compliance with a law do not include any amount paid or incurred which the taxpayer elects to pay in lieu of a fine or penalty or as forfeiture or disgorgement. In addition, under proposed §1.162-21(f)(3)(iii)(D), restitution, remediation, and amounts paid to come into compliance with a law do not include any amount paid or incurred to an entity; to a fund, including a restitution, remediation, or other fund; to a group; or to a government or governmental entity, to the extent it was not harmed by the taxpayer’s violation or potential violation of a law. In addition, proposed §1.162-21(f)(3)(iii)(A) adopts the rule in section 162(f)(2)(B) to exclude any amounts paid or incurred as reimbursement to the government or governmental entity for investigation costs or litigation costs from restitution or remediation.

Coming into compliance with a law

Under proposed §1.162-21(f)(3)(iii), a payment for a specific corrective action, or to provide specific property, is treated as an amount paid to come into compliance with a law. Proposed §1.162-21(f)(3)(ii)(II) provides that restitution, remediation, or to come into compliance with a law.

Investigation or inquiry into a potential violation of a law

In response to Notice 2018-23, a commenter requested clarification that an amount paid or incurred in relation to the investigation or inquiry into the potential violation of a law does not include amounts paid in the ordinary course of business as required by law. In general, section 162(f) does not disallow a deduction for amounts paid or incurred for audits, inspections, or reviews conducted in the ordinary course of business if the payment is otherwise deductible as an ordinary and necessary business expense and is not related to the violation of a law or the investigation or inquiry into the potential violation of a law as described in section 162(f)(1). The Treasury Department and the IRS request comments about specific examples of audits, inspections, or reviews conducted in the ordinary course of business that are not investigations or inquiries of potential violations of law intended to fall within the ambit of section 162(f).

D. Material change

A commenter asked for clarification that an amendment to an order or agreement, entered into before December 22, 2017, that does not change the nature or purpose of the payment obligation or create a new payment obligation, does not cause the order or agreement to be treated as entered into after December 22, 2017. Proposed §1.162-21(e) provides that, if the parties to an order or agreement, that became binding under applicable law, before December 22, 2017, make a material change to the terms of this original order or agreement on or after the applicability date of the final regulations, proposed §1.162-21(a) will apply to any amounts paid or incurred, or any obligation to provide property or services, after the date of the material change. Material changes are described in proposed §1.162-21(e)(2).

E. Establishment requirement

Section 162(f)(2)(A)(i) requires that a taxpayer establish that an amount was paid as restitution or remediation, or that the amount was paid to come into compliance with a law.

Proposed §1.162-21(b)(3)(ii) provides that the taxpayer may satisfy the establishment requirement by providing documentary evidence (1) That the taxpayer was legally obligated to pay the amount or agreement identified as restitution, remediation, or to come into compliance with a law; (2) of the amount paid or incurred, or any obligation to provide property or services, after the date of the material change. Material changes are described in proposed §1.162-21(e)(2).

Commenters requested that the regulations address the documents, or other evidence, that a taxpayer may present to meet the establishment requirement. In addition, commenters expressed concern that it may be difficult for taxpayers to meet the requirement when the government has control of the information that establishes the amount identified in the order or agreement. Proposed §1.162-21(b)(3)(ii) provides a non-exhaustive list of doc-
ments that taxpayers may use to satisfy the establishment requirement. Reporting of the amount by a government or governmental entity under section 6050X and proposed §1.6050X-1(a) alone does not satisfy the establishment requirement. The Treasury Department and the IRS request comments about other evidence and supporting documentation taxpayers may use to meet the establishment requirement.

F. Identification requirement

Section 162(f)(2)(A)(ii) requires an order or agreement to identify an amount paid or incurred as restitution, remediation, or to come into compliance with a law. Under proposed §1.162-21(b)(2)(i), an order or agreement identifies a payment by stating the nature of, or purpose for, each payment each taxpayer is obligated to pay and the amount of each payment identified.

To satisfy the identification requirement, proposed §1.162-21(b)(2)(ii) requires the order or agreement to specifically state that the payment, and the amount of the payment, constitutes restitution, remediation, or an amount paid to come into compliance with a law. The proposed rule provides that the identification requirement may be met if the order or agreement uses a different form of the requisite words, such as “remediate” or “comply with a law.”

Commenters expressed the concern that it may not be possible to satisfy the identification requirement in an order or agreement that imposes lump-sum judgments or settlements, multiple damage awards, or involves multiple taxpayers because it is unlikely that the order or agreement will distinguish the amount to be paid as restitution, remediation, or to come into compliance with a law from the disallowed amounts, or allocate the payments among the multiple taxpayers. Therefore, the commenters recommended that the regulations exclude these orders and agreements from the identification requirement of section 162(f)(2)(A)(ii) altogether. The proposed regulations do not adopt the commenters’ recommendation because such an exception would be inconsistent with the statute. The Treasury Department and the IRS request comments on how taxpayers may meet the identification requirement with respect to lump-sum payments, multiple damage awards, and multiple taxpayers.

One commenter expressed the concern that it is beyond the expertise of a government or governmental entity to place a value on restitution or remediation costs, or costs to come into compliance with a law. Another stated that, in general, the compliance or restitution provisions of an order or agreement may not include quantified amounts because neither the up-front, nor ultimate, costs can be determined. The Treasury Department and the IRS request comments about orders or agreements meeting the identification requirement, including when an order or agreement identifies a payment amount which is less than the amount the taxpayer established was paid as restitution, remediation, or to come into compliance with a law.

Other commenters expressed the concern that an order or agreement may require the taxpayer to provide services, provide property, or undertake specific action, to satisfy the legal obligation. These commenters requested that the regulations provide a rule that an order or agreement may meet the identification requirement if it identifies the in-kind settlement or the specified performance as restitution, remediation, or amount paid to come into compliance with a law, even if an actual payment amount is not identified.

To treat taxpayers that, pursuant to the order or agreement, in whole or in part, discharge their liability in-kind in the same manner as taxpayers who make a monetary payment, and to administer the statute in a manner consistent with congressional intent, proposed §1.162-21(b)(2)(iii) addresses how an order or agreement may meet the identification requirement with respect to any amount paid or incurred that is not identified. The proposed rule provides, if the order or agreement identifies a payment as restitution, remediation, or to come into compliance with a law but does not identify some or all of the aggregate amount the taxpayer must pay, the order or agreement must describe the damage done, harm suffered, or manner of noncompliance with a law, and describe the action required by the taxpayer (such as incurring costs to provide services or to provide property) with respect to the damage, harm, or noncompliance.

Under proposed §1.162-21(b)(2)(iv), the IRS may challenge the characterization of an amount identified under proposed §1.162-21(b)(2). No deduction is allowable unless the identification requirement is met. H.R. Rep. No. 115-466, at 430 (2017). Reporting of the amount by a government or governmental entity under section 6050X and proposed §1.6050X-1(a) alone does not satisfy the identification requirement.

G. Suits between private parties

If the amount is otherwise deductible under chapter 1, section 162(f)(3) allows a deduction for an amount paid or incurred pursuant to an order or agreement in which no government or governmental entity is a party to a suit. Therefore, section 162(f)(1) disallows a deduction for amounts paid or incurred to, or at the direction of, a government or governmental entity only when a government or governmental entity is a complainant or investigator with respect to the violation or potential violation of a law. A court-directed payment or the entry of a judgment in a lawsuit between private parties is not a payment made at the direction of a government. H.R. Rep. No. 115-466, at 430 (2017). Proposed section 1.162-21(c)(1) provides that section 162(f)(1) does not apply to any amount paid or incurred by reasons of any order or agreement in a suit in which no government or governmental entity is a party.

H. Taxes and related interest

Section 162(f)(4) provides that section 162(f)(1) does not apply to any amount paid or incurred as “taxes due.” “Taxes due” includes interest on taxes but not interest, if any, with respect to any related penalties imposed. See Joint Committee on Taxation, General Explanation of Public Law 115-97, at 194 (December 2018). Proposed §1.162-21(c)(2) provides that proposed §1.162-21(a) does not apply to amounts paid or incurred as otherwise deductible taxes or related interest. However, if penalties are imposed with respect to those otherwise deductible taxes, proposed §1.162-21(a) disallows a deduction
for the interest paid with respect to such penalties.

I. Failure to pay Title 26 tax

In accordance with section 162(f)(2)(A)(iii), proposed §1.162-21(c)(3) provides that, in the case of any amount paid or incurred as restitution for failure to pay tax imposed under Title 26, section 162(f)(1) does not disallow a deduction otherwise allowed under chapter 1. For example, section 162(f)(1) and proposed §1.162-21(a) do not disallow a deduction of an amount paid or incurred as restitution for failure to pay a Federal income tax is disallowed because section 275(a)(1) provides that no deduction is allowed for Federal income taxes.

J. Taxable year of deduction

Under proposed §1.162-21(d)(1), deductions allowed under proposed §§1.162-21(b) or (c), are taken into account under the rules of section 461 and the related regulations, or the rules specifically applicable to the allowed deduction, such as the rules of §1.468B-3(c).

K. Tax benefit income

If the deduction allowed under proposed §1.162-21(b) or (c) results in a tax benefit to the taxpayer, proposed §1.162-21(d)(2) requires the taxpayer to include in income, under sections 61 and 111, the recovery of any amount deducted in a prior taxable year to the extent the prior year’s deduction reduced the taxpayer’s tax liability.

2. Reporting Information With Respect To Certain Fines, Penalties, and Other Amounts

The purpose of the proposed regulations under section 6050X is to provide appropriate officials of governments or governmental entities the operational, administrative, and definitional rules for complying with the statutory information reporting requirements with respect to certain suits or agreements to which section 162(f) and proposed §1.162-21(f)(4) apply.

In general, under proposed §1.6050X-1(a), if the aggregate amount a payor is required to pay pursuant to an order or agreement with respect to a violation, investigation, or inquiry to which section 162(f) and proposed §1.162-21 apply equals or exceeds the threshold amount under proposed §1.6050X-1(g)(5), the appropriate official of a government or governmental entity that is a party to the order or agreement must file an information return with the IRS with respect to the amounts paid or incurred and any additional information required by the information return and the related instructions, including the payor’s taxpayer identification number. The appropriate official of a government or governmental entity that is a party to the order or agreement must also furnish a written statement with the same information to the payor.

Reporting of the amount by a government or governmental entity under section 6050X and proposed §1.6050X-1(a) alone does not satisfy the identification requirement under section 162(f)(2)(A)(ii) and proposed §1.162-21(b)(2)(ii) or the establishment requirement under section 162(f)(2)(A)(i) and proposed §1.162-21(b)(3).

A. Definitions

Government, governmental entity, or nongovernmental entity treated as a governmental entity

To lessen the administrative burden on certain entities, the proposed definition of “government or governmental entity” in §1.6050X-1(g)(2) is narrower than the definition provided in proposed §1.162-21(f)(1) because it requires reporting only from certain of the governments and governmental entities described in proposed §1.162-21(f)(1). Specifically, the government of the United States, a State, or the District of Columbia, under proposed §1.162-21(f)(1)(i), or a political subdivision, or a corporation or other entity serving as an agency or instrumentality, thereof, are each treated under the proposed regulations as a government or governmental entity that must comply with the information reporting requirements of section 6050X and proposed §1.6050X-1. In addition, a nongovernmental entity, under proposed §1.162-21(f)(2), that exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)) or exercises self-regulatory powers, including adopting, administering, or enforcing laws and imposing sanctions, as part of performing an essential governmental function, also must comply with the information reporting requirements of section 6050X and proposed §1.6050X-1.

In contrast, as a result of government-to-government consultation with tribal leaders, the Treasury Department and the IRS have determined that imposing the reporting requirements of section 6050X and proposed §1.6050X-1 on Indian tribal governments, as defined in section 7701(a)(40), subdivisions of Indian tribal governments, as determined in accordance with section 7871(d), or a corporation or other entity serving as an agency or instrumentality of any Indian tribal government would not contribute to the efficient administration of the internal revenue laws. Additionally, consistent with general principles of comity, the proposed definition of “government or governmental entity” in §1.6050X-1(g)(2) excludes foreign governments, governments of U.S. territories, or any political subdivision, or corporation or other entity serving as an agency or instrumentality, thereof.

Although a particular entity is excluded from the information reporting requirements of section 6050X and proposed §1.6050X-1, amounts paid or incurred to all categories of entities described in proposed §1.162-21(f)(1) are subject to the limitations on deductibility set forth in proposed §1.162-21.

Appropriate official

Section 6050X(c) defines “appropriate official” of a government or governmental entity as the officer or employee having control of the suit, investigation, or inquiry, or an appropriately designated person. Proposed §1.6050X-1(g)(1) adopts this statutory definition and further provides that the appropriate official may instead be the officer or employee of the govern-
ment or governmental entity assigned to comply with the information reporting requirements of section 6050X.

One commenter observed that more than one government or governmental entity may be involved in the same order or agreement and suggested that the appropriate official be an official from only one government or governmental entity. The Treasury Department and the IRS agree with this comment generally. To minimize the burden on governments or governmental entities from having to report the same amount more than once, and to ensure the efficient administration of the internal revenue laws, proposed §1.6050X-1(g)(1)(ii) (A) provides a general rule that, if more than one government or governmental entity is a party to an order or agreement, only the appropriate official of the government or governmental entity listed first, for example as the first signatory, on the most recently executed order or agreement is responsible for complying with all section 6050X information reporting and furnishing requirements. To provide governments or governmental entities with greater flexibility, proposed §1.6050X-1(g)(1)(ii) (B) permits the governments or governmental entities to appoint one or more other appropriate officials to be responsible for complying with the information reporting and furnishing requirements. The Treasury Department and the IRS request comments about assigning an appropriate official to comply with the information reporting and furnishing requirements if more than one government or governmental entity are parties to the order or agreement.

Payor

Proposed §1.6050X-1(g)(4) defines “payor” as the person, as defined in section 7701(a)(1), which, pursuant to an order or agreement, has paid or incurred, or is liable to pay or incur, an amount to, or at the direction of, the government or governmental entity in relation to the violation or potential violation of a law. In general, the payor will be the person to which section 162(f) and proposed §1.162-21 apply.

Threshold amount

Section 6050X(a)(2)(B) provides the Secretary with the authority to adjust the statutory reporting threshold of $600 as necessary to ensure the efficient administration of the internal revenue laws.

Based on comments received from governments and governmental entities concerned about the burden of information reporting and to ensure the efficient administration of the internal revenue laws, the Treasury Department and the IRS have determined that a threshold higher than $600 is appropriate to address these concerns. Proposed §1.6050X-1(g)(5) provides that reporting is required for payment amounts equal to or in excess of $50,000 (threshold amount).

The Treasury Department and the IRS request comments concerning the proposed threshold amount in consideration of the anticipated compliance burden on filers. In particular, the Treasury Department and the IRS request data on the annual number of relevant orders issued, or agreements entered into, by governments or governmental entities as well as the financial, time, and administrative burdens associated with different threshold amounts.

B. Requirement to file return

Under proposed §1.6050X-1(b)(1), the information return filed by the government or governmental entity must provide the aggregate amount a payor is required to pay as a result of the order or agreement, the separate amounts required to be paid as restitution, remediation, or to come into compliance with a law as a result of the order or agreement, and any additional information required by the information return and the related instructions.

Section 6050X(a)(3) requires the information return to be filed at the time the agreement is entered into, as determined by the Secretary. Commenters observed that it would be burdensome and inefficient to file information returns each time an agreement is entered into or an order is issued. In order to reduce the reporting burden, several commenters suggested that the regulations require annual filing of information returns to be made by a specific date in the year following the date the agreement is entered into or the order is issued. The Treasury Department and the IRS agree with this comment and have adopted it in the proposed regulations.

Accordingly, the appropriate official of a government or governmental entity must comply with the information reporting requirement of proposed §1.6050X-1(a) and (b) by filing Form 1096, Fines, Penalties, and Other Amounts (or any successor form), with Form 1096, Annual Summary and Transmittal of U.S. Information Returns, on or before the annual due date as provided in proposed §1.6050X-1(b)(2).

Several commenters expressed concerns about the information reporting requirements with respect to an order or agreement pursuant to which payments are made over the course of several years. To minimize the burden on governments or governmental entities and to ensure the efficient administration of the internal revenue laws, proposed §1.6050X-1 does not require an appropriate official to file information returns for each taxable year in which a payor makes a payment pursuant to a single order or agreement. Instead, the appropriate official must file only one information return for the aggregate amount identified in the order or agreement.

C. Requirement to furnish written statement

Proposed §1.6050X-1(c) requires the appropriate official of a government or governmental entity who fulfills the requirement under section 6050X(a) and proposed §1.6050X-1(a)(1) to furnish a written statement to each payor with respect to which it is required to file an information return under paragraphs (a) (1) and (b) of §1.6050X-1. For purposes of tax administration, the requirement to “furnish” written statements requires that those with a reporting obligation must provide statements to certain recipients containing the information reported to the IRS and, in some cases, additional information. Under section 6050X, the payor is the recipient. The written statement must include the information that was reported on the information return and a legend that identifies the statement as important tax information that is being furnished to the IRS. To minimize the burden on governments or governmental entities, the proposed regulations permit the appropriate official to comply with the requirements under section 6050X(b) and proposed §1.6050X-1(a)(2) by furnishing a copy
of Form 1098-F to the payor. Regardless of when the appropriate official furnishes the statement to the payor, the timing of any deduction allowed under proposed §1.162-21 is governed by the general principles of Federal income tax law, as set forth in proposed §1.162-21(d).

D. Due dates

Section 6050X(a)(3) provides that the information return shall be filed at a time the agreement is entered into, as determined by the Secretary. Further, section 6050X(b) requires the written statement to be furnished to the payor at the same time the information return is filed with the IRS. Under proposed §1.6050X-1(b)(2), the information return must be filed on or before January 31 of the year following the calendar year in which the order or agreement becomes binding under applicable law, even if all appeals have not been exhausted with respect to the suit, agreement, or otherwise.

The return is due on or before January 31 whether it is filed on paper or electronically. Although the due date for filing electronic Forms 1098-F under proposed §1.6050X-1(b)(2) differs from the general March 31 due date provided in section 6071(b), which applies with respect to electronically filed information returns under sections 6041 through 6050Y, the specific provisions of section 6050X take precedence over the general March 31 due date. To ensure that the payor has the information necessary to prepare the payor’s income tax return, and as directed by section 6050X(b), proposed §1.6050X-1(c)(3) requires the appropriate official to furnish the written statement, under proposed §1.6050X-1(c)(1), on or before the date that the appropriate official files the Form 1098-F with the IRS (January 31).

E. Rules for multiple payors

Proposed §1.6050X-1(d) describes the application of paragraphs (a), (b), and (c) of §1.6050X-1 if, pursuant to the order or agreement, the aggregate amount multiple payors are required to pay, or the costs to provide the property or the service, equals or exceeds the threshold amount. If, pursuant to the order or agreement, more than one payor is individually liable for some or all of the payment amount, proposed §1.6050X-1(d)(1) requires the appropriate official to file an information return for the separate amount that each individually liable payor is required to pay, even if a payor’s payment liability is less than the threshold amount, and to furnish a written statement containing this information to each payor. If more than one person (as defined in section 7701(a)(1)) is a party to an order or agreement, there is no information reporting requirement, or requirement to furnish a written statement, with respect to any person who does not have a payment obligation or obligation for costs to provide services or to provide property.

Proposed §1.6050X-1(d)(2) provides that, if an order or agreement identifies multiple jointly and severally liable payors, the appropriate official must file an information return for each payor reporting the aggregate amount to be paid by all jointly and severally liable payors. The appropriate official must furnish a written statement containing this information to each of those payors, regardless of which payor makes the payment.

F. Payment amount not identified

Some orders or agreements may identify a payment, or an obligation to provide property or to provide services, as restitution, remediation, or an amount paid to come into compliance with a law, without identifying some or all of the aggregate amount the payor must pay, or some or all of the aggregate cost to provide property or services. Proposed §1.6050X-1(e) provides that, if the government or governmental entity expects, under the facts and circumstances, that the amount the payor must pay, plus any other costs the payor will incur, pursuant to the order or agreement will equal or exceed the threshold amount, the appropriate official of such government or governmental entity must file an information return on Form 1098-F (or any successor form), as provided in the instructions to the Form 1098-F, and furnish a written statement to the payor with the information supplied to the IRS on Form 1098-F. For example, if the United States Environmental Protection Agency (EPA) issues an order requiring a payor to come into compliance with the underlying legal requirements of the Clean Water Act, 33 U.S.C. section 1251 et seq., by undertaking work, and the EPA expects, under the facts and circumstances, that the payor or all of the payment amount, proposed §1.6050X-1(d)(1) requires the appropriate official to file an information return for the separate amount that each individually liable payor is required to pay, even if a payor’s payment liability is less than the threshold amount, and to furnish a written statement containing this information to each payor. If more than one person (as defined in section 7701(a)(1)) is a party to an order or agreement, there is no information reporting requirement, or requirement to furnish a written statement, with respect to any person who does not have a payment obligation or obligation for costs to provide services or to provide property.

Proposed §1.6050X-1(d)(2) provides that, if an order or agreement identifies multiple jointly and severally liable payors, the appropriate official must file an information return for each payor reporting the aggregate amount to be paid by all jointly and severally liable payors. The appropriate official must furnish a written statement containing this information to each of those payors, regardless of which payor makes the payment.

G. Material change

If there is a material change in the terms of an order or agreement, as defined in proposed §1.162-21(e)(2) for which the appropriate official has filed an information return, proposed §1.6050X-1(f) requires the appropriate official to update the IRS by filing a corrected information return, and to furnish an amended written statement to the payor, with respect to the entire order or agreement, and not just the terms modified. The proposed rules require the appropriate official to file the corrected Form 1098-F, on paper or electronically, as provided by the General Instructions for Certain Information Returns, on or before January 31 of the year following the calendar year in which the parties make a material change to the terms of the order or agreement. The proposed rules also require the appropriate official to furnish an amended written statement to the payor on or before the date that the corrected Form 1098-F is filed with the IRS.

Proposed Applicability Dates

The rules of proposed §1.162-21 are proposed to apply to taxable years beginning on or after the date of publication of the Treasury decision adopting the rules of proposed §1.162-21 as final regulations in the Federal Register, except that such rules do not apply to amounts paid or incurred under any order or agreement which became binding under applicable law before such date. Until that date, taxpayers may rely on the rules of proposed §1.162-21, for any order or agreement,
but only if the taxpayers apply the rules in their entirety and in a consistent manner. See section 7805(b)(7). Additionally, the rules of proposed §1.6050X-1 are proposed to apply only to orders and agreements that become binding under applicable law on or after January 1, 2022.

Special Analyses

1. 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 potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. The preliminary EO 13771 designation is regulatory.

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

A. Background

Prior to the TCJA, section 162(f) of the Code disallowed a deduction for any fine or similar penalty paid to a government for the violation of a law. This provision, enacted in 1969, codified existing case law that denied business deductions for fines or similar penalties. The general rule of section 162(f)(1), as amended by section 13306(a) of the TCJA, disallows any deduction for amounts paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity or certain nongovernmental entities treated as governmental entities, in relation to the violation of a law or the investigation or inquiry by such government or entity into the potential violation of a law. Section 13306(a) also provides certain exceptions to this disallowance. Section 162(f)(2) does not disallow deduction for amounts that (1) the taxpayer establishes were paid or incurred as restitution (including remediation of property) or to come into compliance with a law, and (2) are identified in the court order or settlement agreement as restitution, remediation, or to come into compliance with a law.

In addition, under prior law, the Treasury Department and the IRS did not receive information returns from governments or governmental entities that received fines or penalties. Section 6050X of the Code, enacted by section 13306(b) of the TCJA, requires appropriate officials to file an information return if the aggregate amount involved in all orders or agreements with respect to the violation, investigation, or inquiry is $600 or more. The information return must include (1) The amount required to be paid as a result of the order or agreement; (2) any amount that constitutes restitution or remediation of property; and (3) any amount required to be paid for the purpose of coming into compliance with a law that was violated or involved in the investigation or inquiry. Section 6050X provides the Secretary with the authority to adjust the $600 reporting threshold in order to ensure efficient tax administration.

B. Need for the Proposed Regulations

The Treasury Department and the IRS have received several questions and comments from Federal, state, local, and tribal governments, as well as the public, regarding the meaning of various provisions in each section and issues not explicitly addressed in the statute. The Treasury Department and the IRS have determined that such comments warrant the issuance of further guidance.

In addition, the Treasury Department and the IRS have determined that increasing the reporting threshold to reduce the reporting burden and to enhance the efficiency of tax administration is appropriate.

C. Overview of the Proposed Regulations

The proposed regulations provide guidance regarding sections 162(f) and 6050X. The following analysis provides further detail regarding the anticipated impacts of the proposed regulations. Part I.D specifies the baseline for the economic analysis. Part I.E.1. summarizes the economic effects of the rulemaking, relative to this baseline. Part I.E.2. describes the economic effects of specific provisions covering (1) the reporting threshold, (2) the timing of information reporting, and (3) information reporting requirements when payment amounts are not identified.

D. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the proposed regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these proposed regulations.

E. Economic Analysis of the Proposed Regulation

I. Summary of Economic Effects

The proposed section 162(f) regulations provide definitions for restitution, remediation, and amounts paid to come into compliance with the law. These definitions clarify for taxpayers which amounts paid or incurred may be deductible under the statute. The proposed regulations also clarify (1) how the taxpayer meets the establishment requirement; and (2) how the order or agreement meets the identification requirement. The Treasury Department and the IRS have determined that the burden reduction associated with the proposed regulations for section 162(f) is modest. In addition, while the proposed regulations reduce uncertainty for taxpayers, they are unlikely to affect firms’ economic decision-making because most of the amounts to be paid or incurred which are subject to section 162(f) are non-discretionary.

The proposed regulations under section 6050X provide certainty and consistency for affected governments and governmental entities by defining and clarifying the statute’s terms and rules. Further, the
proposed regulations use the authority provided by the statute to the Secretary to set information reporting requirements to minimize the burden on governments and governmental entities and to ensure the efficient administration of the internal revenue laws. Most importantly, the proposed regulations increase the reporting threshold from $600 to $50,000, thereby eliminating information reporting requirements for an estimated 1 to 5 million orders or agreements. Using the midpoint of this range (3 million), the estimated burden reduction from this exercise of regulatory discretion is $74 million (2018 dollars) per year. The Treasury Department and the IRS acknowledge that limited quantitative data makes estimates of the number of affected orders and agreements uncertain, and request comments or data that can help improve these estimates.

II. Economic Analysis of Specific Provisions

The effects of the information reporting requirements are discussed in more detail in sections II.A, B, and C. The Treasury Department and the IRS solicit comments on the economics of each of the items discussed subsequently and of any other items of the proposed regulations not discussed in this section. The Treasury Department and the IRS particularly solicit comments that provide data, other evidence, or models that could enhance the rigor of the process by which provisions might be developed for the final regulations.

A. Reporting Threshold

Section 6050X requires governments and governmental entities which enter orders or agreements to which section 162(f) applies to file an information return if the aggregate amount paid or incurred in all orders or agreements with respect to the violation, investigation, or inquiry is equal to or exceeds a threshold of $600. Section 6050X also provides the Secretary with the authority to adjust the statutory reporting threshold as necessary to ensure efficient tax administration. In response to multiple comments received from governments and governmental entities concerned about the burden of information reporting for smaller payment amounts pursuant to orders or agreements, the proposed regulations raise the reporting threshold to $50,000. The Treasury Department and the IRS request comments on this proposed threshold amount. In particular, data on the annual number of orders or agreements by governments or governmental entities would be helpful.

The Treasury Department and the IRS considered a range of alternative thresholds including the statutory threshold of $600, along with much higher thresholds suggested by some commenters. Upon consideration of both the enforcement needs of the IRS and the reporting burden on governments and governmental entities, the Treasury Department and the IRS exercised the authority provided to the Secretary by the statute to set the reporting threshold amount at $50,000.

The Treasury Department and the IRS do not know of any data on the number of orders or agreements requiring taxpayers to pay amounts to, or at the direction of, governments or governmental entities, or the distribution of these amounts, such as the number that are above or below $600. Based on communications with stakeholders, the Treasury Department and the IRS estimate that the increase in reporting threshold from $600 to $50,000 will reduce the number of required information returns by 1 to 5 million. The Treasury Department and the IRS further estimate that the average time to complete the information return is between 0.387 and 0.687 hours. Using the midpoint of each of these ranges (3 million information returns and .537 hours) and labor cost of $46 per hour, the Treasury Department and the IRS estimate that increasing the reporting threshold will reduce annual compliance burdens by $74 million dollars (2018 dollars) per year. It should be noted that many of the lower level fines and penalties are likely to be assessed to non-businesses that are not able to deduct business expenses so they would be unaffected by any reporting requirement.

Increasing the reporting threshold from $600 to $50,000 is unlikely to have a significant effect on revenues as fines over $50,000 likely account for the vast majority of fines and penalties in terms of dollar values. Based on financial reporting values disclosed on tax returns of C corporations, S corporations and Partnerships, firms with over $50,000 in total fines and penalties account for 99% of all fines and penalties. However, this data should be interpreted with caution. Financial reporting of fines and penalties includes both international and domestic fines, and all fines and penalties are aggregated into yearly totals. Furthermore, firms with less than $10 million in assets are not required to provide financial reporting values with their tax returns.

The Treasury Department and the IRS solicit comments on this threshold and cost estimates and particularly solicit comments that provide data that would enhance the rigor by which the threshold is decided for the final regulations.

B. Time of Reporting

Section 6050X provides that the government or governmental entity shall file the information return at the time the order or agreement is entered into, as determined by the Secretary. The Treasury Department and the IRS received comments from governments and governmental entities observing that it would be burdensome and inefficient to file information returns each time an order or agreement becomes binding under applicable law. Several commenters suggested that annual filing of information returns would meaningfully reduce this reporting burden. The Treasury Department and the IRS agree with this comment and have adopted it in the proposed regulations.

Several commenters also expressed uncertainty and concern about the information reporting requirements for an order or agreement pursuant to which payments are made over the course of several years. To reduce uncertainty, and to minimize the burden on governments and governmental entities, the proposed regulations clarify that information reporting is required only for the year in which the order or agreement becomes binding under applicable law, and not required for each taxable year in which a payor makes a payment.

1This data point is derived by the IRS as part of the burden analysis described in the Paperwork Reduction Act section below.
The Treasury Department and the IRS considered requiring information reporting at the time the order is issued or the agreement is entered. The Treasury Department and the IRS also considered requiring information reporting in each year in which an amount is paid or incurred pursuant to the order or agreement. However, both alternative approaches were determined to impose unnecessary burden for governments and governmental entities without creating accompanying benefits for tax administration or for taxpayers.

The Treasury Department and the IRS solicit comments on the timing of reporting and particularly solicit comments that provide data regarding how timing of reporting affects compliance burdens.

C. Payment Amount Not Identified

When the expected amount paid or incurred pursuant to an order or agreement equals or exceeds the threshold amount, section 6050X requires governments or governmental entities to file an information return including (1) The amount required to be paid as a result of the order or agreement; (2) any amount that constitutes restitution or remediation of property; and (3) any amount required to be paid for the purpose of coming into compliance with a law that was violated or involved in the investigation or inquiry. However, some orders or agreements may involve uncertain payments or costs to provide property or services without identifying some or all of the aggregate amount the payor must pay (or some or all of the aggregate cost to provide property or services). The Treasury Department and the IRS received comments expressing concern that amounts paid or incurred are often difficult to assess, and strict valuation requirements would impose undue burden on governments and governmental entities. For situations in which the amount is not identified, the proposed regulations direct governments and governmental entities to the instructions to Form 1098-F. To address commenters’ concerns, these instructions will permit governments and governmental entities to report the threshold amount of $50,000 when the amount is unknown but expected to equal or exceed $50,000. This rule is necessary to improve taxpayer compliance.

The Treasury Department and the IRS considered requiring governments and governmental entities to provide an estimate of each amount to be paid or incurred; however this approach was rejected because it would impose significant burden for governments and governmental entities.

D. Summary

In summary, the proposed section 162(f) regulations and section 6050X regulations result in modest burden reduction, with the exception of the increase in the threshold amount, which is estimated to reduce burden by $74 million (2018 dollars) per year. The Treasury Department and the IRS projected that the proposed regulations, taken together, would have a non-revenue economic effect of less than $100 million (2018 dollars) per year. The Treasury Department and the IRS request comments on the economic effects of these proposed regulations.

Paperwork Reduction Act

Collection of Information – Form 1098-F

In general, the collection of information in the proposed regulations is required under section 6050X of the Internal Revenue Code (the Code). The collection of information in these proposed regulations is set forth in proposed §1.6050X-1. The IRS intends that the collection of information pursuant to section 6050X will be conducted by way of Form 1098-F, Fines, Penalties, and Other Amounts. For purposes of the PRA, the reporting burden associated with the collection of information with respect to section 6050X will be reflected in the IRS Forms 14029 Paperwork Reduction Act Submission associated with Form 1098-F. Form 1098-F will be used by all governments, governmental entities, and nongovernmental entities treated as governmental entities with a reporting requirement. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations. In addition, when available, drafts of IRS forms are posted for comment at www.irs.gov/draftforms.

The current status of the PRA submissions related to section 6050X are provided in the following table.

<table>
<thead>
<tr>
<th>Form</th>
<th>Type of Filer</th>
<th>OMB Number</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>1098-F</td>
<td>Governments, Governmental Entities, And Certain Nongovernmental Entities</td>
<td>1545-2284</td>
<td>Form 1098-F is approved through 1/31/2023.</td>
</tr>
</tbody>
</table>

A reasonable burden estimate for the average time to complete Form 1098-F is between 0.387 and 0.687 hours (approximately 23 to 41 minutes). This estimate is based on survey data collected from similar information return issuers. In addition, the increase in the reporting threshold under section 6050X will lead to a decrease in the number of informa-
tion returns filed by between 1 million to 5 million returns. Using the midpoint of these ranges, or 3 million and 0.537 hours, the estimated burden reduction is $74 million per year.

*Estimated average time per form:* .537 hours.

*Estimated number of respondents:* 90,100.

*Estimated total annual burden hours:* 48,383.70.

*Estimated change in number of information returns resulting from increased reporting threshold:* (3,000,000).

*Estimated change in burden (hours):* (1,611,150).

*Estimated change in burden (Dollars):* ($74,161,235).

The Treasury Department and the IRS request comments on all aspects of these estimates.

Comments on the collection of information in proposed §1.6050X-1(a) should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury at oira_submission@omb.eop.gov or Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by June 12, 2020.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the duties of the IRS, including whether the information will have practical utility (including underlying assumptions and methodology);

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

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 26 U.S.C. 6103.

**Regulatory Flexibility Act**

The Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6) requires agencies to “prepare and make available for public comment an initial regulatory flexibility analysis,” which will “describe the impact of the proposed rule on small entities.” 5 U.S.C. 603(a). Section 605(b) of the RFA allows an agency to certify a rule if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

Pursuant to the RFA, it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the RFA.

The RFA generally applies to regulations that affect small businesses, small organizations, and small governmental jurisdictions. For purposes of the RFA, small governmental jurisdictions are governments of cities, counties, towns, townships, villages, school districts, or special districts with a population of less than 50,000. This proposed rule would affect States, as well as local governments, some of which may meet the definition of small governmental jurisdiction. Approximately 90,100 governments, governmental entities, and nongovernmental entities treated as governmental entities may be subject to the reporting requirements of section 6050X. Of those governments and governmental entities, approximately 85,500 (or 95%) are small governmental jurisdictions.

Although the regulations may affect a substantial number of small governmental jurisdictions, the economic impact of the proposed regulations is not likely to be significant. The proposed regulations set a reporting threshold that is higher than the minimum required by statute and also provide for governments and governmental entities to file annual returns. Both of these provisions reduce the potential burden on small governmental jurisdictions. In particular, the increase in the reporting threshold will lead to a decrease in the number of information returns filed by between 1 million to 5 million returns. Using the midpoint of this range, or 3 million, the estimated burden reduction is $74 million per year (2018 dollars). It is estimated that after reading and learning about the requirements of the regulations, the burden associated with filing the annual form is approximately 23 to 41 minutes and the average cost per information return is approximately $24.72, which would not result in a significant economic impact on small entities. The Treasury Department and the IRS request comments on the burden associated with filing the annual form.

Notwithstanding this certification, the Treasury Department and the IRS invite comments on any impact this rule would have on small entities. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small entities.

**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. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

**Executive Order 13132: Federalism**

Executive Order 13132 (entitled Federalism) prohibits an agency from publishing any rule that has Federalism
implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These proposed rules do not have Federalism implications, and do not impose substantial direct compliance costs on state and local governments or preempt state law, within the meaning of the Executive Order. The compliance costs, if any, are imposed on state and local governments by section 6050X, as enacted by the TCJA. Notwithstanding, the Treasury Department and the IRS have engaged in efforts to consult and work cooperatively with affected State and local officials in the process of developing the proposed rules by participating in a teleconference with the National League of Cities on September 27, 2019, and the National Governors Association on October 2, 2019. Pursuant to the requirements set forth in section 8(a) of Executive Order 13132, the Treasury Department and the IRS certify that they have complied with the requirements of Executive Order 13132.

Executive Order 13175: Consultation and Coordination with Indian Tribal Governments

Executive Order 13175 (entitled Consultation and Coordination with Indian Tribal Governments) requires consultation and collaboration with tribal officials in the development of Federal policies that may have tribal implications. In order to obtain tribal input in accordance with Executive Order 13175 and consistent with Treasury’s Tribal Consultation Policy (80 FR 57434, September 23, 2015), the Treasury Department and the IRS held a Tribal Consultation with tribal officials on September 12, 2019. The Treasury Department and the IRS will obtain additional input on the tribal implications of the proposed rules before publishing them as final rules.

Comments and Requests for a Public Hearing

Before these proposed amendments to the regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the “ADDRESSES” section. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are also encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the Federal Register. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Statement of Availability of IRS Documents


Drafting Information

The principal author of these regulations is Sharon Y. Horn of Associate Chief Counsel (Income Tax and Accounting), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes; Reporting and record-keeping requirements

Proposed Amendments to the Regulations

Accordingly, 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 entries in numerical order to read in part as follows:

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

Section 1.6050X-1 also issued under 26 U.S.C. 6050X(a), (b).

Par. 2. Section 1.162-21 is revised to read as follows:

§ 1.162-21 Denial of deduction for certain fines, penalties, and other amounts.

(a) Deduction Disallowed. Except as otherwise provided in this section, no deduction is allowed under chapter 1 of the Internal Revenue Code (Code) for any amount that is paid or incurred—

(1) By suit, settlement agreement (agreement), or otherwise;

(2) To or at the direction of a government or governmental entity, as defined in paragraph (f)(1) of this section, or a non-governmental entity, as defined in paragraph (f)(2) of this section; and

(3) In relation to the violation, or investigation or inquiry into the potential violation, of any civil or criminal law.

(b) Exception for restitution, remediation, and amounts paid to come into compliance with a law—(1) In general. Paragraph (a) of this section does not apply to amounts paid or incurred for restitution, remediation, or to come into compliance with a law, as defined in paragraphs (f)(3) of this section, provided that both the identification and the establishment requirements of paragraphs (b)(2) and (b)(3) of this section are met.

(2) Identification requirement.

(i) In general. A court order (order) or an agreement identifies a payment by stating the nature of, or purpose for, each payment each taxpayer is obligated to pay and the amount of each payment identified.

(ii) Meeting the identification requirement. The identification requirement is presumed to be met if an order or agreement specifically states that the payment, and the amount of the payment, described in paragraph (b)(2)(i) of this section, constitutes restitution, remediation, or an amount paid to come into compliance with a law or if the order or agreement uses a different form of the required words, such as, “remediate” or “comply with a law.” Meeting the establishment requirement

Bulletin No. 2020–23

923

June 1, 2020
of paragraph (b)(3) of this section alone is not sufficient to meet the identification requirement of paragraph (b)(2) of this section.

(iii) Payment amount not identified. If the order or agreement identifies a payment as restitution, remediation, or to come into compliance with a law but does not identify some or all of the aggregate amount the taxpayer must pay, the identification requirement may be met, with respect to any payment amount not identified, if the order or agreement describes the damage done, harm suffered, or manner of noncompliance with a law, and describes the action required of the taxpayer, such as paying or incurring costs to provide services or to provide property.

(iv) Challenge by the IRS. The IRS may challenge the characterization of an amount identified under paragraph (b)(2) of this section. To rebut the presumption described in paragraph (b)(2)(ii) of this section, the IRS must develop sufficient contrary evidence that the amount paid or incurred was not for the purpose identified in the order or agreement.

(3) Establishment requirement.

(i) Meeting the establishment requirement. The establishment requirement is met if the taxpayer substantiates, with documentary evidence, the taxpayer’s legal obligation, pursuant to the order or agreement, to pay the amount identified as restitution, remediation, or to come into compliance with a law, the amount paid, and the date the amount was paid or incurred. Meeting the identification requirement of paragraph (b)(2) of this section alone is not sufficient to meet the establishment requirement of paragraph (b)(3) of this section.

(ii) Substantiating the establishment requirement. The documentary evidence described in paragraph (b)(3)(i) of this section includes, but is not limited to, receipts; the legal or regulatory provision related to the violation or potential violation of a law; documents issued by the government or governmental entity relating to the investigation or inquiry; documents describing how the amount to be paid was determined; and correspondence exchanged between the taxpayer and the government or governmental entity before the order or agreement became binding under applicable law.

(c) Other Exceptions.

(1) Suits between private parties. Paragraph (a) of this section does not apply to any amount paid or incurred by reason of any order or agreement in a suit in which no government or governmental entity is a party.

(2) Taxes and related interest. Paragraph (a) of this section does not apply to amounts paid or incurred as otherwise deductible taxes or related interest. However, if penalties are imposed with respect to these taxes, paragraph (a) of this section applies to disallow a deduction for any interest payments related to the penalties imposed.

(3) Failure to pay Title 26 tax. In the case of any amount paid or incurred as restitution for failure to pay tax imposed under Title 26 of the United States Code, paragraph (a) of this section does not disallow a deduction for Title 26 taxes which is otherwise allowed under chapter 1 of the Code.

(d) Application of general principles of Federal income tax law.

(1) Taxable year of deduction. If, under paragraph (b) or (c) of this section, the taxpayer is allowed a deduction for the amount paid or incurred pursuant to an order or agreement, the deduction is taken into account under the rules of section 461 and the related regulations, or under a provision specifically applicable to the allowed deduction, such as §1.468B-3(c).

(2) Tax benefit rule applies. If the deduction allowed under paragraphs (b) or (c) of this section results in a tax benefit to the taxpayer, the taxpayer must include in income, under sections 61 and 111, the recovery of any amount deducted in a prior taxable year to the extent the prior year’s deduction reduced the taxpayer’s tax liability.

(i) A tax benefit to the taxpayer includes a reduction in the taxpayer’s tax liability for that year or the creation of a net operating loss carryback or carryover.

(ii) A taxpayer’s recovery of any amount deducted in a prior taxable year includes, but is not limited to—

(A) Receiving a refund, recoupment, rebate, reimbursement, or otherwise recovering some or all of the amount the taxpayer paid or incurred, or

(B) Being relieved of some or all of the payment liability under the order or agreement.

(e) Material change to order or agreement.

(1) In general. If the parties to an order or agreement, entered before December 22, 2017, make a material change to the terms of that order or agreement on or after the applicability date in paragraph (h) of this section, paragraph (a) of this section applies to any amounts paid or incurred, or any obligation to provide property or services, after the date of the material change.

(2) Material change. A material change to the terms of an order or agreement under paragraph (e)(1) of this section may include: changing the nature or purpose of a payment obligation; or changing, adding to, or removing a payment obligation, an obligation to provide services, or an obligation to provide property. A material change does not include changing a payment date or changing the address of a party to the order or agreement.

(f) Definitions. For purposes of section 162(f) and §1.162-21, the following definitions apply:

(1) Government or governmental entity. A government or governmental entity means—

(i) The government of the United States, a State, or the District of Columbia;

(ii) The government of a territory of the United States, including American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands;

(iii) The government of a foreign country;

(iv) An Indian tribal government, as defined in section 7701(a)(40), or a subdivision of an Indian tribal government, as determined in accordance with section 7871(d); or

(v) A political subdivision of (i), (ii), or (iii), or a corporation or other entity serving as an agency or instrumentality of any of paragraph (f)(1)(i)-(f)(iv) of this section.

(2) Nongovernmental entity treated as a governmental entity.

(i) A nongovernmental entity described in paragraph (f)(2)(i) of this section is treated as a governmental entity.
(ii) A nongovernmental entity treated as governmental entity is an entity that—

(A) Exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)); or

(B) Exercises self-regulatory powers, including adopting; administering; or enforcing laws and imposing sanctions, as part of performing an essential governmental function.

(3) Restitution, remediation of property, and amounts paid to come into compliance with a law.

(i) An amount is paid or incurred for restitution or remediation pursuant to paragraph (b)(1) of this section if it restores, in whole or in part, the person, as defined in section 7701(a)(1); the government; the governmental entity; or property harmed by the violation or potential violation of a law described in paragraph (a)(3) of this section.

(ii) An amount is paid or incurred to come into compliance with a law that the taxpayer has violated, or is alleged to have violated, by performing services; taking action, such as modifying equipment; providing property; or doing any combination thereof.

(iii) Regardless of whether the order or agreement identifies them as such, restitution, remediation, and amounts paid to come into compliance with a law do not include any amount paid or incurred—

(A) To reimburse the government or governmental entity for investigation costs or litigation costs;

(B) At the payor’s election, in lieu of a fine or penalty;

(C) As forfeiture or disgorgement; or

(D) To the extent the payment or contribution does not meet the requirements of paragraph (f)(3)(i) or (ii) of this section, to an entity; fund, including a restitution, remediation, or other fund; group; government or governmental entity .

(4) Suit, agreement, or otherwise. A suit, agreement, or otherwise includes, but is not limited to, settlement agreements, non-prosecution agreements, deferred prosecution agreements, judicial proceedings, administrative adjudications, decisions issued by officials, committees, commissions, boards of a government or governmental entity, and any legal actions or hearings which impose a liability on the taxpayer or pursuant to which the taxpayer assumes liability.

(g) Examples. The application of this section may be illustrated by the following examples.

(1) Example 1. Identification and establishment requirements.

(i) Facts. Corp. A enters into an agreement with State Y’s environmental enforcement agency (Agency) for violating state environmental laws. Under the terms of the agreement, Corp. A must pay $40,000 to the Agency in civil penalties, $80,000 in restitution for environmental harm, $50,000 for remediation of contaminated sites, and $60,000 to conduct comprehensive upgrades to Corp. A’s operations to come into compliance with the state environmental laws.

(ii) Analysis. The identification requirement is satisfied for those amounts the agreement identifies as restitution, remediation, or to come into compliance with a law. If Corp. A establishes, as provided in paragraph (b)(3) of this section, that the amounts it paid or incurred are for restitution, remediation, and to come into compliance with state environmental laws, paragraph (a) of this section does not preclude Corp. A from deducting $190,000. Under paragraph (a) of this section, Corp. A may not deduct the $40,000 in civil penalties. Section 162(f) and §1.162-21(a) will not disallow Corp. A’s deduction for the $60,000 paid to come into compliance with the state environmental laws. However, Corp. A may deduct the $60,000 paid only if, under the facts and circumstances, the payment would be otherwise deductible under chapter 1 of the Code. See section 161, concerning items allowed as deductions, and section 261, concerning items for which no deduction is allowed, and the regulations related to sections 161 and 261.

(2) Example 2. Restitution.

(i) Facts. Corp. A enters into an agreement with State T’s securities agency (Agency) for violating a securities law by inducing B to make a $100,000 investment in Corp. C stock, which B lost when the Corp. C stock became worthless. As part of the agreement, Corp. A agrees to pay $100,000 to B as restitution for B’s investment loss, incurred as a result of Corp. A’s actions. The agreement specifically states that the $100,000 payment by Corp. A to B is restitution. The agreement also requires Corp. A to pay a $40,000 fine to the Agency as a result of Corp. A’s misconduct.

(ii) Analysis. Corp. A’s $100,000 payment to B is identified in the agreement as restitution. If Corp. A establishes, as provided in paragraph (b)(3) of this section, that the amount paid was for that purpose, Corp. A may deduct the $100,000 payment. Paragraph (a) of this section precludes Corp. A from deducting its payment of $40,000 to the Agency because the payment of a fine is not treated as restitution, remediation, or as paid to come into compliance with a law.

(3) Example 3. Amount paid to come into compliance with a law.

(i) Facts. Corp. B, an accrual method taxpayer, is under investigation by State X’s environmental enforcement agency for a potential violation of State X’s law governing emissions standards. Corp. B enters into an agreement with State X under which it agrees to upgrade the engines in a fleet of vehicles that Corp. B operates to come into compliance with State X’s law. Although the agreement does not provide the specific amount Corp. B will incur to upgrade the engines to come into compliance with State X’s law, it identifies that Corp. B must upgrade existing engines to lower certain emissions. Under the agreement, Corp. B also agrees to bring certain machinery, already in compliance with State X law, up to a standard higher than that which the law requires, and to construct a nature center in a local park for the benefit of the community. Corp. B presents invoices, as described in paragraph (b)(3)(ii) of this section, to substantiate that the expenses Corp. B will incur to upgrade the engines will be amounts paid to come into compliance with State X’s law.

(ii) Analysis. Because the agreement describes the specific action Corp. B must take to come into compliance with State X’s law, and Corp. B provides evidence, as described in paragraph (b)(3)(ii) of this section, to establish that the agreement obligates it to incur costs to come into compliance with a law, paragraph (a) of this section would not preclude a deduction for the amounts Corp. B incurs to come into compliance. However, Corp. B may not deduct the amounts paid to bring its machinery up to a higher standard than required by State X’s law or to construct the nature center because no facts exist to establish that either amount was paid to come into compliance with a law or as restitution or remediation.

(4) Example 4. At the direction of a government.

(i) Facts. Corp. D enters into an agreement with governmental entity, Consumer Board, for violating consumer protection laws by failing to provide debt-relief services it promised its customers. The agreement requires Corp. D to pay $60,000 as restitution to the customers harmed by Corp. D’s violation of the law.

(ii) Analysis. At the direction of Consumer Board, Corp. D must pay $60,000 to its customers as a result of its violation of the law. The agreement identifies the $60,000 as restitution. Provided Corp. D establishes, under paragraph (b)(3) of this section, that the $60,000 constitutes restitution, paragraph (a) of this section does not apply.

(h) Applicability date. The rules of this section are proposed to apply to taxable years beginning on or after the date of publication of the Treasury decision adopting these rules as final regulations is published in the Federal Register, except that such rules do not apply to amounts paid or incurred under any order or agreement that became binding under applicable law before such date. Until that date, taxpayers may rely on these proposed rules for any order or agreement, but only if the taxpayers apply the rules in their entirety and in a consistent manner.

Par. 3. Add §1.6050X-1 to read as follows:

§1.6050X-1 Information reporting for fines, penalties, and other amounts by governments, governmental entities, and
nongovernmental entities treated as governmental entities.

(a) Information reporting requirement. The appropriate official (as described in paragraph (g)(1) of this section) of a government or governmental entity (as described in paragraph (g)(2) of this section) or nongovernmental entity treated as a governmental entity (as described in paragraph (g)(3) of this section) that is a party to a suit, agreement, or otherwise to which section 162(f) and §1.162-21(f)(4) apply, must—

(1) File an information return (as described in paragraph (b) of this section) if the aggregate amount the payor (as described in paragraph (g)(4) of this section) is required to pay pursuant to all court orders (orders) and settlement agreements (agreements), with respect to the violation of a law, or the investigation or inquiry into the potential violation of a law, equals or exceeds the threshold amount provided in paragraph (g)(5) of this section; and

(2) Furnish a written statement as described in paragraph (c) of this section to each payor.

(b) Requirement to file return.

(1) Content of information return. The information return must provide the following:

(i) The aggregate amount required to be paid to, or at the direction of, a government or governmental entity as a result of the order or agreement;

(ii) The separate amounts required to be paid as restitution, remediation, or to come into compliance with a law, as defined in §1.162-21(f)(3), as a result of the order or agreement; and

(iii) Any additional information required by the information return and the related instructions.

(2) Form, manner, and time of reporting. The appropriate official required, under paragraph (a)(1) of this section, to file an information return must file Form 1098-F, Fines, Penalties, and Other Amounts, (or any successor form), with Form 1096, Annual Summary and Transmittal of U.S. Information Returns. The information return must be filed with the Internal Revenue Service (IRS) on or before January 31 of the year following the calendar year in which the order or agreement becomes binding under applicable law. The January 31 due date applies to both paper and electronically filed information returns.

(c) Requirement to furnish written statement.

(1) In general. The appropriate official must furnish a written statement to each payor with respect to which it is required to file an information return under paragraphs (a)(1) and (b) of this section. The written statement must include:

(i) The information that was reported to the IRS with respect to such payor; and

(ii) A legend that identifies the statement as important tax information that is being furnished to the IRS.

(2) Copy of the Form 1098-F. The appropriate official may satisfy the requirement of this paragraph (c) by furnishing a copy of the Form 1098-F (or any successor form) filed with respect to the payor, or another document that contains the information required by paragraph (c)(1) if the document conforms to applicable revenue procedures (see §601.601) or other guidance relating to substitute statements.

(3) Time for furnishing written statement. The appropriate official must furnish the written statement to the payor on or before the date that the appropriate official files the Form 1098-F with the IRS, as provided in paragraph (b)(2) of this section.

(d) Rules for multiple payors.

(1) Multiple payors — individual liability. If, pursuant to an order or agreement, the sum of the aggregate amount that multiple individually liable payors must pay with respect to a violation, investigation, or inquiry equals, or exceeds, the threshold amount under paragraph (g)(5) of this section, the appropriate official must file an information return under paragraphs (a)(1) and (b) of this section to report the amount required to be paid by each payor, even if a payor’s payment liability is less than the threshold amount. The appropriate official must furnish a written statement, under paragraph (c) of this section, to each payor. If more than one person (as defined in section 7701(a)(1)) is a party to an order or agreement, there is no information reporting requirement, or requirement to furnish a written statement, with respect to any person who does not have a payment obligation or obligation for costs to provide services or to provide property.

(2) Multiple payors — joint and several liability. If, pursuant to an order or agreement, multiple payors are jointly and severally liable to pay an amount that, in the aggregate, equals or exceeds the threshold amount under paragraph (g)(5) of this section, the appropriate official must file an information return, under paragraphs (a) (1) and (b) of this section for each of the jointly and severally liable payors. Each information return must report the aggregate amount required to be paid by all of the payors. The appropriate official must furnish a written statement, under paragraph (c) of this section, to each of the jointly and severally liable payors.

(e) Payment amount not identified. If, as provided by §1.162-21(b)(2)(iii), the order or agreement identifies a payment (or the cost to provide property or to provide services) as restitution, remediation, or an amount paid to come into compliance with a law (as defined in §1.162-21(f)(3)), but does not identify some or all of the aggregate amount the payor must pay (or some or all of the aggregate cost to provide property or to provide services) and, under the facts and circumstances, the government or governmental entity expects the amount to equal or exceed the threshold amount under paragraph (g)(5) of this section, for purposes of paragraphs (a), (b), and (c) of this section, the appropriate official must file an information return, and furnish the written statement to the payor, as provided by the instructions to Form 1098-F (or any successor form), including instructions as to the amounts (if any) to include on Form 1098-F.

(f) Material change. If the parties make a material change, as described in §1.162-21(e)(2), to the terms of an order or agreement for which an appropriate official has filed Form 1098-F (or any successor form), the appropriate official must update the IRS by filing a corrected Form 1098-F (or any successor form), as provided by the form instructions, with respect to the entire amended order or agreement, not just the terms modified. The appropriate official must file the corrected Form 1098-F with the IRS on or before January 31 of the year following the calendar year in which the parties make a material change to the terms of the order or agreement. The appropriate official must furnish an
amended written statement to the payor on or before the date that the appropriate official files the corrected Form 1098-F with the IRS.

(g) Definitions. For purposes of this section, the following definitions apply—

(1) Appropriate official.

(i) One government or governmental entity. If the government or governmental entity has not assigned one of its officers or employees to comply with the reporting requirements of paragraph (a), (b), and (c) of this section, the term “appropriate official” means the officer or employee of a government or governmental entity having control of the suit, investigation, or inquiry. If the government or governmental entity has assigned one of its officers or employees to comply with the reporting requirements of paragraph (a), (b), and (c) of this section, such officer or employee is the appropriate official.

(ii) More than one government or governmental entity.

(A) In general. If more than one government or governmental entity is a party to an order or agreement, only the appropriate official of the government or governmental entity listed first on the most recently executed order or agreement is responsible for complying with all reporting requirements under paragraphs (a), (b), and (c) of this section, unless another appropriate official is appointed by agreement under paragraph (g)(1)(ii)(B) of this section.

(B) By agreement. The governments or governmental entities that are parties to an order or agreement may agree to appoint one or more other appropriate officials to be responsible for complying with the information reporting requirements of paragraphs (a), (b), and (c) of this section.

(2) Government or governmental entity. For purposes of this section, government or governmental entity means—

(i) The government of the United States, a State, or the District of Columbia; or

(ii) A political subdivision of, or a corporation or other entity serving as an agency or instrumentality of any of paragraph (g)(2)(i) of this section.

(3) Nongovernmental entity treated as governmental entity. For purposes of this section, the definition of nongovernmental entity set forth in §1.162-21(f)(2) applies.

(4) Payor. The payor is the person (as defined in section 7701(a)(1)) who, pursuant to an order or agreement has paid or incurred, or is liable to pay or incur, an amount to, or at the direction of, a government or governmental entity in relation to the violation or potential violation of a law. In general, the payor will be the person to which section 162(f) and §1.162-21 of the regulations apply.

(5) Threshold amount. The threshold amount is $50,000.

(h) Applicability date. The rules of this section are proposed to apply only to orders and agreements that become binding under applicable law on or after January 1, 2022.

Sunita Lough
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on May 12, 2019, 8:45 a.m., and published in the issue of the Federal Register for May 13, 2019, 85 F.R. 28524)
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 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.
CI—City.
COOP—Cooperative.
C.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Det. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.

EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
FR—Federal Register.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
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.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferor.
TFR—Transferor.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
X—Corporation.
Y—Corporation.
Z—Corporation.
Numerical Finding List¹

Bulletin 2020–23

AOD:
2020-1, 2020-12 I.R.B. 521
2020-2, 2020-14 I.R.B. 558
2020-3, 2020-17 I.R.B. 663

Announcements:
2020-1, 2020-5 I.R.B. 552
2020-2, 2020-15 I.R.B. 609
2020-3, 2020-15 I.R.B. 655
2020-4, 2020-17 I.R.B. 667
2020-5, 2020-19 I.R.B. 796
2020-6, 2020-23 I.R.B. 911

Notices:
2020-1, 2020-2 I.R.B. 290
2020-2, 2020-3 I.R.B. 327
2020-3, 2020-3 I.R.B. 330
2020-4, 2020-4 I.R.B. 380
2020-5, 2020-4 I.R.B. 380
2020-6, 2020-7 I.R.B. 411
2020-7, 2020-7 I.R.B. 411
2020-8, 2020-7 I.R.B. 415
2020-9, 2020-7 I.R.B. 417
2020-10, 2020-10 I.R.B. 456
2020-11, 2020-11 I.R.B. 492
2020-12, 2020-11 I.R.B. 495
2020-14, 2020-13 I.R.B. 555
2020-15, 2020-14 I.R.B. 559
2020-16, 2020-14 I.R.B. 559
2020-17, 2020-15 I.R.B. 590
2020-18, 2020-15 I.R.B. 590
2020-19, 2020-15 I.R.B. 591
2020-20, 2020-16 I.R.B. 660
2020-21, 2020-16 I.R.B. 660
2020-22, 2020-17 I.R.B. 664
2020-23, 2020-18 I.R.B. 742
2020-26, 2020-18 I.R.B. 744
2020-27, 2020-19 I.R.B. 778
2020-28, 2020-19 I.R.B. 781
2020-30, 2020-19 I.R.B. 781
2020-31, 2020-19 I.R.B. 783
2020-32, 2020-21 I.R.B. 837
2020-34, 2020-21 I.R.B. 838
2020-36, 2020-21 I.R.B. 840
2020-25, 2020-22 I.R.B. 863
2020-29, 2020-22 I.R.B. 864
2020-33, 2020-22 I.R.B. 868
2020-37, 2020-23 I.R.B. 900
2020-38, 2020-23 I.R.B. 903

Proposed Regulations:
REG-107431-19, 2020-3 I.R.B. 332
REG-122180-18, 2020-3 I.R.B. 342
REG-100956-19, 2020-4 I.R.B. 383
REG-125710-18, 2020-5 I.R.B. 554
REG-132741-17, 2020-10 I.R.B. 458
REG-100814-19, 2020-12 I.R.B. 542
REG-132529-17, 2020-12 I.R.B. 667
REG-106013-19, 2020-18 I.R.B. 757
REG-117138-17, 2020-19 I.R.B. 796
REG-106864-18, 2020-20 I.R.B. 805
REG-113295-18, 2020-22 I.R.B. 875
REG-104591-18, 2020-23 I.R.B. 911

Revenue Procedures:
2020-1, 2020-01 I.R.B. 1
2020-2, 2020-01 I.R.B. 107
2020-3, 2020-01 I.R.B. 131
2020-4, 2020-01 I.R.B. 148
2020-5, 2020-01 I.R.B. 241
2020-7, 2020-01 I.R.B. 281
2020-9, 2020-02 I.R.B. 294
2020-10, 2020-02 I.R.B. 295
2020-11, 2020-06 I.R.B. 406
2020-8, 2020-08 I.R.B. 447
2020-12, 2020-11 I.R.B. 511
2020-13, 2020-11 I.R.B. 515
2020-17, 2020-12 I.R.B. 539
2020-18, 2020-15 I.R.B. 592
2020-14, 2020-16 I.R.B. 661
2020-22, 2020-18 I.R.B. 745
2020-23, 2020-18 I.R.B. 749
2020-24, 2020-18 I.R.B. 750
2020-26, 2020-18 I.R.B. 753
2020-25, 2019 I.R.B. 785
2020-28, 2019-19 I.R.B. 792
2020-20, 2020-20 I.R.B. 801
2020-27, 2020-20 I.R.B. 803
2020-29, 2020-21 I.R.B. 859
2020-19, 2020-22 I.R.B. 871
2020-21, 2020-22 I.R.B. 872
2020-30, 2020-22 I.R.B. 873
2020-15, 2020-23 I.R.B. 905

Revenue Rulings:
2020-1, 2020-3 I.R.B. 296
2020-2, 2020-3 I.R.B. 298
2020-3, 2020-3 I.R.B. 409
2020-4, 2020-4 I.R.B. 444
2020-5, 2020-5 I.R.B. 454
2020-6, 2020-11 I.R.B. 490
2020-7, 2020-12 I.R.B. 522
2020-9, 2020-15 I.R.B. 563
2020-10, 2020-15 I.R.B. 565

Revenue Rulings:—Continued
2020-8, 2020-19 I.R.B. 775
2020-11, 2020-19 I.R.B. 776

Treasury Decisions:
9886, 2020-2 I.R.B. 285
9887, 2020-3 I.R.B. 302
9888, 2020-3 I.R.B. 306
9891, 2020-8 I.R.B. 419
9892, 2020-8 I.R.B. 439
9893, 2020-9 I.R.B. 449
9895, 2020-15 I.R.B. 565
9896, 2020-18 I.R.B. 681
9897, 2020-23 I.R.B. 882

¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.
Finding List of Current Actions on Previously Published Items

Bulletin 2020–23

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INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at www.irs.gov/irb/.

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