

# INTERNAL REVENUE BULLETIN



## HIGHLIGHTS OF THIS ISSUE

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

## INCOME TAX

### **Notice 2020-53, page 151.**

In response to the ongoing Coronavirus Disease 2019 (COVID-19) pandemic, this notice provides temporary relief from certain requirements under § 42 of the Internal Revenue Code (Code) for qualified low-income housing projects and under §§ 142(d) and 147(d) of the Code for qualified residential rental projects.

### **REG-112339-19, page 155.**

This document contains proposed regulations regarding the credit for carbon oxide sequestration under section 45Q of the Internal Revenue Code (Code). These proposed regulations will affect persons who physically or contractually ensure the capture and disposal of qualified carbon oxide, use of qualified carbon oxide as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, or utilization of qualified carbon oxide in a manner that qualifies for the credit.

### **REG-117589-18, page 184.**

These proposed regulations provide rules under section 1031 of the Internal Revenue Code relating to the non-recognition of gain or loss on exchanges of certain property for other property of like kind. The proposed regulations amend the existing regulations under section 1031 to add a defi-

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nition of real property to reflect statutory changes limiting section 1031 to exchanges of real property. The proposed regulations also provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in the exchange.

### **REG-125716-18, page 197.**

This document contains proposed regulations under section 1502 of the Internal Revenue Code (the Code). The proposed regulations would update existing regulations under section 1.1502-21 to reflect statutory changes made to section 172 of the Code by the Tax Cuts and Jobs Act, P.L. 115-97 (Dec. 22, 2017) and the Coronavirus Aid, Relief, and Economic Security Act, P.L. 116-36 (Mar. 27, 2020). The proposed regulations would affect taxpayers that file consolidated returns.

### **T.D. 9900, page 143.**

Section 2303 of the "Coronavirus Aid, Relief, and Economic Security Act," Pub. L. No. 116-136, 134 Stat. 281 (March 27, 2020) (the "CARES Act"), amended the carryback provisions related to net operating losses. As a result of the CARES Act amendments, which specifically extended the carryback period for certain net operating losses, these temporary regulations permit certain acquiring consolidated groups to elect to waive all or a portion of the pre-acquisition portion of the extended carryback period under section 172 for certain losses attributable to certain acquired members.

# The IRS Mission

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

## Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

### **Part II.—Treaties and Tax Legislation.**

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

### **Part III.—Administrative, Procedural, and Miscellaneous.**

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

### **Part IV.—Items of General Interest.**

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

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

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# Part I

26 CFR 1.1502-21T: Carryback of Consolidated Net Operating Losses

## T.D. 9900

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

#### Carryback of Consolidated Net Operating Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

**SUMMARY:** This document contains temporary regulations under section 1502 of the Internal Revenue Code (Code) that affect corporations filing consolidated returns. These regulations permit consolidated groups that acquire new members that were members of another consolidated group to elect in a year subsequent to the year of acquisition to waive all or part of the pre-acquisition portion of an extended carryback period under section 172 of the Code for certain losses attributable to the acquired members where there is a retroactive statutory extension of the NOL carryback period under section 172. These regulations respond to the enactment of section 2303 of the CARES Act, which retroactively extends the carryback period under section 172 for taxable years beginning after 2017 and before 2021.

**DATES: Effective date:** These temporary regulations are effective on July 2, 2020.

**Applicability date:** For the date of applicability, see §1.1502-21T(h)(9).

**FOR FURTHER INFORMATION CONTACT:** Jonathan R. Neuville, at (202) 317-5363 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:** The text of these temporary regulations

also serves as the text of part of the proposed regulations set forth in the related notice of proposed rulemaking on this subject (REG-125716-18) in the Proposed Rules section in this issue of the **Federal Register**.

#### Background

This Treasury decision amends the Income Tax Regulations (26 CFR part 1) under section 1502 of the Code. Section 1502 authorizes the Secretary of the Treasury or his delegate (Secretary) to prescribe regulations for an affiliated group of corporations that join in filing (or that are required to join in filing) a consolidated return (consolidated group) to reflect clearly the Federal income tax liability of the consolidated group and to prevent avoidance of such tax liability. See §1.1502-1(h) (defining the term “consolidated group”). For purposes of carrying out those objectives, section 1502 also permits the Secretary to prescribe rules that may be different from the provisions of chapter 1 of the Code that would apply if the corporations composing the consolidated group filed separate returns. Terms used in the consolidated return regulations generally are defined in §1.1502-1.

The Department of the Treasury (Treasury Department) and the IRS are issuing these temporary regulations to provide guidance to consolidated groups regarding the application of the net operating loss (NOL) carryback rules under section 172(b) of the Code, as amended by (i) section 2303(b) of the Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136, 134 Stat. 281 (March 27, 2020) (CARES Act), and (ii) any future statutory amendments to section 172. Specifically, if there is a retroactive statutory extension of the NOL carryback period under section 172, these temporary regulations permit consolidated groups that acquired new members that were members of another consolidated group prior to the statutory change to elect to waive, in a taxable year subsequent to the taxable year of the acquisition, all or part of the pre-acquisition portion of an extended carryback period (as defined in part I

of the Explanation of Provisions) under section 172 for consolidated net operating losses (CNOLs) attributable to the acquired members.

#### I. NOL Carrybacks and Carryovers under Section 172

For purposes of section 172, an NOL equals the excess of a taxpayer’s deductions allowed by chapter 1 of the Code over the taxpayer’s gross income, computed with the modifications specified in section 172(d). Section 172(c). For a taxable year beginning before January 1, 2021, section 172(a)(1) allows as a deduction an amount equal to the aggregate of the NOL carryovers and carrybacks to such year. As amended by section 2303(b)(2) of the CARES Act, section 172(b)(1)(A)(i) of the Code provides that an NOL for any taxable year must be an NOL carryback to the extent provided in section 172(b)(1)(B), 172(b)(1)(C)(i), and 172(b)(1)(D).

#### A. Tax Cuts and Jobs Act amendments to section 172

Prior to enactment of the CARES Act, section 172 was most recently amended by Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). In relevant part, section 13302(b) of the TCJA amended section 172(b) to generally prohibit the carryback of NOLs arising in taxable years beginning after December 31, 2017 (post-2017 NOLs). The TCJA also provided limited exceptions to the general carryback prohibition by amending sections 172(b)(1)(B) and 172(b)(1)(C)(i) to provide that farming losses (within the meaning of section 172(b)(1)(B)(ii)) and losses incurred by insurance companies (as defined in section 816(a) of the Code) other than life insurance companies (nonlife insurance companies), respectively, must be carried back to each of the two taxable years preceding the taxable year of the loss. Therefore, prior to enactment of the CARES Act, taxpayers generally could not carry back post-2017 NOLs to prior taxable years.

**B. CARES Act amendments to section 172**

Section 2303(b) of the CARES Act added section 172(b)(1)(D) to the Code. This provision contains an additional exception to the general prohibition of NOL carrybacks. Specifically, section 172(b)(1)(D) provides that an NOL arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, must be carried back to each of the five taxable years preceding the taxable year in which that NOL arises (five-year carryback period). Section 172(b)(2) requires taxpayers to carry the entire amount of such NOL back to the earliest taxable year of that five-year carryback period. Section 172(b)(2) also provides that the portion of the NOL that must be carried to each successive taxable year in the five-year carryback period equals the amount, if any, that was not used in the preceding taxable years to which the NOL was carried.

Section 172(b)(1)(D)(i)(II), as added by section 2303(b)(1) of the CARES Act, further provides that the exceptions to the prohibition of NOL carrybacks regarding farming losses and nonlife insurance companies do not apply to NOLs that are subject to the five-year carryback period. See sections 172(b)(1)(B)(i) (regarding farming losses) and 172(b)(1)(C)(i) (regarding nonlife insurance companies). Therefore, farming losses and losses incurred by nonlife insurance companies arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, are carried back five years instead of two years. Section 172(b)(1)(D)(i)(II).

**C. Election to waive carryback under section 172(b)(3)**

Section 172(b)(3) permits a taxpayer entitled to a carryback period under section 172(b)(1) to make, with respect to an NOL for any taxable year, an irrevocable election to relinquish the carryback period. A taxpayer generally must make this election (i) in such manner as may be prescribed by the Secretary, and (ii) by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the NOL for which the election is to be in effect. However, solely with regard to NOLs arising in a taxable year begin-

ning in 2018 or 2019, section 172(b)(1)(D)(v)(II), as added by section 2303(b)(1) of the CARES Act, provides a special rule that requires elections to waive the carry-back period for such NOLs under section 172(b)(3) to be made no later than the due date (including extensions of time) for filing the taxpayer's Federal income tax return for the first taxable year ending after March 27, 2020. See also Rev. Proc. 2020-24, 2020-18 I.R.B. 750, §§4.01(1), 4.03 (providing procedures regarding the time and manner of filing elections for consolidated groups to waive the carryback under section 172(b)(3) for NOLs arising in taxable years beginning in 2018 or 2019).

**II. Consolidated Return Regulations**

Section 1.1502-21(a) defines the consolidated net operating loss (that is, a CNOL) deduction for any consolidated return year as "the aggregate of the net operating loss carryovers and carrybacks to the year," which consist of (i) CNOLs of the consolidated group, and (ii) any NOLs of the group's members arising in separate return years. A "CNOL" is, for a consolidated return year, the excess of a consolidated group's deductions over the group's gross income, as determined under §1.1502-11(a) (without regard to any CNOL deduction). See §1.1502-21(e).

**A. General rules regarding NOL carryovers and carrybacks**

The NOL carryovers and carrybacks to a taxable year are determined under the principles of section 172 and §1.1502-21. Section 1.1502-21(b)(1). Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. Id. If any percentage of the CNOL that is attributable to a member (determined pursuant to §1.1502-21(b)(2)(iv)(B)) may be carried to a separate return year of the member, the amount of the CNOL that is attributable to the member is apportioned to the member and carried to the separate return year. Section 1.1502-21(b)(2)(i). If carried

back to a separate return year, the apportioned loss may not be carried back to an equivalent, or earlier, consolidated return year of the group. Id.

**B. General waiver election to relinquish entire carryback**

Section 1.1502-21(b)(3)(i) permits a consolidated group to make an irrevocable election under section 172(b)(3) to relinquish the entire carryback period with respect to a CNOL for any consolidated return year (general waiver election). When making this general waiver election for a consolidated return year, a consolidated group cannot make this election separately for a particular member (whether or not it remains a member). Section 1.1502-21(b)(3)(i). Rather, the consolidated return regulations provide only a narrowly scoped "split-waiver election" (as described in detail in part II.C of this Background) that a consolidated group can make solely with respect to one or more members that previously were members of another group. Id. A general waiver election must be made in a separate statement filed with the group's Federal income tax return for the consolidated return year in which the NOL arises. Id.

**C. Special election for acquisitions of members that were members of another consolidated group**

A consolidated group (acquiring group) that acquires a new member (acquired member) that was a member of another consolidated group (former group) may make an irrevocable election to relinquish, with respect to all CNOLs of the acquiring group that are attributable to the acquired member, the portion of the carryback period for which the acquired member was a member of a former group (split-waiver election). See §1.1502-21(b)(3)(ii)(B). If an acquiring group makes a split-waiver election for a consolidated return year, the portion of the acquiring group's CNOL attributable to the acquired member for which the election is made will not be carried back to a former group. Id. Unlike a general waiver election, a split-waiver election is not a yearly election, but rather applies to all CNOLs attributable to an acquired member that otherwise would be

carried back to a taxable year of a former group under section 172. *Id.*

Eligibility for a split-waiver election is subject to certain conditions and procedures. Importantly, a split-waiver election must be made in a separate statement filed with the acquiring group's original Federal income tax return for the year the corporation became a member. *Id.* In other words, if a split-waiver election is not made with this particular Federal income tax return, the election cannot later be made by amending this return in a subsequent consolidated return year or by attaching the above-described statement to a Federal income tax return for a later consolidated return year. If any other corporation joining the acquiring group was affiliated with the acquired member immediately before the acquired member joined the acquiring group, that other corporation also must be included in the split-waiver election. *Id.*

## Explanation of Provisions

### I. In General

On prior occasions, enacted legislation has amended section 172 to extend the carryback period for NOLs. See Worker, Homeownership, and Business Assistance Act of 2009, Public Law 111-92, 123 Stat. 2984 (November 6, 2009); Job Creation and Worker Assistance Act of 2002, Public Law 107-147, 116 Stat. 21 (March 9, 2002). Most recently, section 2303(b) of the CARES Act added section 172(b)(1)(D) to the Code. As described in part I of the Background, section 172(b)(1)(D) requires (in the absence of a waiver under section 172(b)(3)) a five-year carryback period for an NOL that arises in a taxable year beginning after December 31, 2017, and before January 1, 2021.

Such statutory changes to NOL carryback periods uniquely impact consolidated groups that acquire one or more corporations prior to the statutory extension of the carryback period. During the past two decades, the Treasury Department and the IRS have provided consolidated groups with certain additional elections for waiving carrybacks of losses into other, former groups. See 75 FR 35643 (June 23, 2010) (2010 split-waiver regulations); 67 FR 38000 (May 31, 2002) (2002 split-waiver

regulations). These additional elections, while responsive to particular statutory amendments, have reflected common policy objectives of providing affected groups with the ability to waive all or a portion of the statutorily extended NOL carryback period.

The Treasury Department and the IRS have determined that it is appropriate to provide similar rules with regard to amendments to the NOL carryback rules under section 2303(b) of the CARES Act, as well as any similar statutory changes in the future. (For purposes of these regulations, the amended NOL carryback rules implemented by the CARES Act in particular or by future legislation more generally are referred to as the "amended carryback rules.") Therefore, these temporary regulations provide principle-based rules applicable to CNOLs arising in taxable years to which amended carryback rules become applicable after the acquisition of a member. Under these rules, which are consistent with the 2002 and 2010 split-waiver regulations (although these rules are not limited to a one-time statutory change of the NOL carryback rules), acquiring groups would possess the opportunity to waive, on a taxable-year-by-taxable-year basis, all or a portion of the carryback period with regard to CNOLs attributable to acquired members for pre-acquisition years during which the acquired members were members of a former group.

Therefore, these temporary regulations provide two additional types of split-waiver elections for consolidated groups that (i) include one or more acquired members, and (ii) have CNOLs that, under amended carryback rules, become eligible to be carried back for a greater number of years than under statutory law in effect at the time of the acquisition (default carryback period). See the discussion in parts II through IV of this Explanation of Provisions. A default carryback period may consist of zero years in the case of a complete prohibition on carrybacks. The additional years added under amended carryback rules constitute the "extended carryback period." The two additional types of split-waiver elections set forth in these temporary regulations provide relief, and are subject to conditions and procedures, consistent with the applicable split-waiver elections set forth

in the 2002 and 2010 split-waiver regulations.

### II. Amended Statute Split-Waiver Election

These temporary regulations permit an acquiring group to make a special split-waiver election with regard to a CNOL for a consolidated return year in which an acquired member was included in the acquiring group and to which amended carryback rules apply (amended statute split-waiver election). Through this election, an acquiring group can relinquish that part of the extended carryback period during which an acquired member was a member of a former group (for the portion of a CNOL attributable to the acquired member), notwithstanding that the group did not file a split-waiver election for the year in which the acquired member became a member of the acquiring group (as required by § 1.1502-21(b)(3)(ii)(B)). Accordingly, an amended statute split-waiver election applies only to the portion of a CNOL that is attributable to an acquired member for the portion of the carryback period (including the default carryback period and the extended carryback period) during which the acquired member was a member of a former group.

An acquiring group makes an amended statute split-waiver election on a year-by-year basis, consistent with the 2002 and 2010 split-waiver regulations. Consequently, an acquiring group may make this election for the portion of a CNOL attributable to an acquired member that arises in any particular taxable year to which an amended carryback rule applies (amended carryback CNOL), regardless of whether the acquiring group makes such an election for CNOLs arising in other consolidated return years. However, also consistent with the 2002 and 2010 split-waiver regulations, an acquiring group can make an amended statute split-waiver election with respect to an amended carryback CNOL only if any carryback to a taxable year included in the extended carryback period is not claimed on a return or other filing by a former group that is filed on or before the date this election is filed by the acquiring group. Also consistent with the 2002 and 2010 split-waiver regulations, an acquir-

ing group can make an amended statute split-waiver election with respect to an acquired member only if the acquiring group did not file (i) a valid split-waiver election with respect to that acquired member on or before the effective date of the relevant amended carryback rules, or (ii) a general waiver election with respect to a CNOL of the acquiring group from which the amended carryback CNOL is attributed to the acquired member.

The amended statute split-waiver election generally must be made by attaching a statement to the acquiring group's timely filed tax return (including extensions) with regard to the consolidated return year during which the amended carryback CNOL was incurred. In certain circumstances, the statement may be attached to an amended return, but that return must be filed no later than 150 days after the effective date of the relevant amended carryback rules. These regulations also include rules specific to the amendments to section 172 made by section 2303(b) of the CARES Act, which provide an additional option under which the statement may be attached to an amended return filed no later than November 30, 2020 (a date that is 150 days after the date of filing of these temporary regulations). These filing requirements incorporate the principles of the filing requirements set forth in the 2002 and 2010 split-waiver regulations, which were tailored to specific enacted legislation.

### III. Extended Split-Waiver Election

To provide acquiring groups with additional flexibility for making split-waiver elections, these temporary regulations provide a second, alternative split-waiver election (extended split-waiver election) that applies solely to the extended carryback period (that is, the additional carryback years provided under amended carryback rules). Through an extended split-waiver election, an acquiring group can ensure that amended carryback CNOLs are carried back to taxable years of former groups only to the extent those losses would have been carried back under prior law (that is, the default carryback period). In other words, this election affects only the extended carryback period for an acquired member's attributed loss.

The extended split-waiver election and the amended statute split-waiver election are subject to the same conditions and procedures, and provide the same relief, except that the extended split-waiver election waives only the extended carryback period. Therefore, any CNOL carryback to default carryback years would be unaffected by an extended split-waiver election. For example, if the default carryback period were two years and a change in law extended the carryback period to five years, an acquiring group could make an extended split-waiver election to waive the carryback to a former group of only the three additional carryback years with respect to the amended carryback CNOL. Accordingly, the extended split-waiver election is available if losses attributable to the acquired member have been carried back solely to taxable years of a former group in the default carryback period, but not in the extended carryback period.

### IV. Applicability Date

These temporary regulations apply to any CNOLs arising in a taxable year ending after July 2, 2020. However, consistent with the applicability date for the amendments to section 172(b) pursuant to section 2303(b) of the CARES Act, and pursuant to section 7805(b)(2), taxpayers may apply these temporary regulations to any CNOLs arising in a taxable year beginning after December 31, 2017. The applicability of these temporary regulations will expire on June 30, 2023.

### V. Good Cause

The Treasury Department and the IRS are issuing these temporary regulations without prior notice and the opportunity for public comment pursuant to section 553(b)(B) of the Administrative Procedure Act (APA), which provides that advance notice and the opportunity for public comment are not required with respect to a rulemaking when an agency "for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Under the "public interest" prong

of 5 U.S.C. 553(b)(B), the good cause exception appropriately applies where notice and comment would harm, defeat, or frustrate the public interest, rather than serving it.

These temporary regulations, which solely provide certain acquiring groups with elective relief, are necessary to permit certain acquiring groups to elect to waive all or a portion of the carryback period for certain losses attributable to acquired members for pre-acquisition years during which the acquired members were members of a former group. The amended carryback rules enacted by section 2303(b) of the CARES Act apply for NOLs arising in a taxable year beginning after December 31, 2017, and before January 1, 2021. Consequently, good cause arises from the fact that these temporary regulations will affect taxable years of certain acquiring groups for which tax returns already are due or may become due during a period of comment and delayed effectiveness. Deferring the effectiveness of the temporary regulations until after such a period could prevent taxpayers from immediately electing to obtain the intended benefits of section 2303(b) of the CARES Act and increase taxpayer compliance costs and uncertainty because of delay of the time before which relevant acquiring groups could make the elections permitted by the regulations with certainty.

### Special Analyses

#### I. Regulatory Planning and Review

Executive Orders 13771, 13563, and 12866 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, reducing costs, harmonizing rules, and promoting flexibility.

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

The collections of information in these temporary regulations are in §1.1502-21T(b)(3)(ii)(C)(5)(i) and §1.1502-21T(b)(3)(ii)(C)(5)(ii). The information is required to inform the IRS on whether, and to what extent, an acquiring group makes either of the elections described in these temporary regulations.

The collection of information provided by these temporary regulations has been

approved by the Office of Management and Budget (OMB) under control number 1545-0123. For purposes of the Paperwork Reduction Act, 44 U.S.C. 3501 et seq. (PRA), the reporting burden associated with the collection of information in Form 1120 (U.S. Corporation Income Tax Return) will be reflected in the PRA Submission associated with OMB control number 1545-0123.

In general, if the acquiring group makes an election under §1.1502-21T(b)(3)(ii)(C), the acquiring group is required to attach a separate statement to its Form 1120 as provided in §1.1502-21T(b)(3)(ii)

(C)(5)(i) and §1.1502-21T(b)(3)(ii)(C)(5)(ii), respectively. This statement must be filed as provided in §1.1502-21T(b)(3)(ii)(C)(6).

The following table displays the number of respondents estimated to be required to report on Form 1120 with respect to the collections of information required by these temporary regulations. Due to the absence of historical tax data, direct estimates of the number of respondents required to attach a statement to other types of tax returns, as applicable, are not available.

	<b>Number of Respondents (Estimated)</b>
<i>Amended Statute Split-Waiver Election &amp; Extended Split-Waiver Election</i>	
Form 1120	17,500

Source: RAAS:CDW

The numbers of respondents in the table were estimated by the Research, Applied Analytics and Statistics Division (RAAS) of the IRS from the Compliance Data Warehouse (CDW). Data for Form 1120 represents estimates of the total number of taxpayers that may attach an election statement to their Form 1120 to make the elections in §1.1502-21T(b)(3)(ii)(C)(5)(i) and §1.1502-21T(b)(3)(ii)(C)(5)(ii).

It is estimated that 17,500 consolidated entities will be required to attach a

statement under these temporary regulations. The burden associated with the information collections in these temporary regulations are included in aggregated burden estimates for the OMB control number 1545-0123. The burden estimates provided in the OMB control numbers in the following table are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include, but not isolate, the estimated

burden of those information collections associated with these temporary regulations. To guard against over-counting the burden that consolidated tax provisions imposed prior to §1.1502-21T, the Treasury Department and the IRS urge readers to recognize that these burden estimates have also been cited by regulations that rely on the applicable OMB control numbers in order to collect information from the applicable types of filers.

<b>Form</b>	<b>Type of Filer</b>	<b>OMB Number(s)</b>	<b>Status</b>
Form 1120	Corporation	1545-0123	Published in the Federal Register on 9/30/19. Public comment period closed on 11/29/19. Approved by OIRA through 1/31/2021. Link: <a href="https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-f-1120-h-1120-nd">https://www.federalregister.gov/documents/2018/10/09/2018-21846/proposed-collection-comment-request-for-forms-1065-1065-b-1066-1120-1120-f-1120-h-1120-nd</a>

Source: RAAS:CDW

## III. Regulatory Flexibility Act

These temporary regulations do not impose a collection of information on small entities. Further, pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these temporary regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these temporary regula-

tions apply only to corporations that file consolidated Federal income tax returns, and that such corporations tend to be larger businesses. Therefore, these temporary regulations would not create additional obligations for, or impose an economic impact on, small entities.

Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations have been submitted to the Chief Counsel for Advocacy of the Small

Business Administration for comment on its impact on small business.

## 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. In 2020, that threshold is approximately \$156 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

#### 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. These temporary regulations do not have federalism implications, do not impose substantial direct compliance costs on state and local governments, and do not preempt state law within the meaning of the Executive Order.

#### Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, and Notices cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

#### Drafting Information

The principal author of these regulations is Jonathan R. Neuville of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

#### List of Subjects

#### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

### PART 1—INCOME TAX

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

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

Par. 2. Section 1.1502-21T is revised to read as follows:

#### *§1.1502-21T Net operating losses (temporary).*

(a) For further guidance, see §1.1502-21(a).

(b) For further guidance, see §1.1502-21(b) introductory text through (b)(2).

(1) and (2) [Reserved]

(3) For further guidance, see §1.1502-21(b)(3) introductory text through (b)(3)(ii)(B).

(i) [Reserved]

(ii)(A) [Reserved]

(B) [Reserved]

(C) *Waiver of carryback period for losses in taxable years to which statutorily amended carryback rules apply—*

(I) *In general.* An acquiring group may make either (but not both) an amended statute split-waiver election or an extended split-waiver election with respect to a particular amended carryback CNOL. (See paragraph (b)(3)(ii)(C)(2) of this section for definitions of terms used in this paragraph (b)(3)(ii)(C) and paragraph (b)(3)(ii)(D) of this section.) These elections are available only if the statutory amendment to the carryback period referred to in paragraph (b)(3)(ii)(C)(2)(iv) of this section occurs after the date of acquisition of an acquired member. A separate election is available for each taxable year to which amended carryback rules apply. An acquiring group may make an amended statute split-waiver election or an extended split-waiver election only if the acquiring group, with regard to that election—

(i) Satisfies the requirements in paragraph (b)(3)(ii)(C)(3) of this section; and

(ii) Follows the procedures in paragraphs (b)(3)(ii)(C)(5) and (6) of this section, as relevant to that election.

(2) *Definitions.* The definitions provided in this paragraph (b)(3)(ii)(C)(2) apply for purposes of this paragraph (b)(3)(ii)(C) and paragraph (b)(3)(ii)(D) of this section.

(i) *Acquired member.* The term *acquired member* means a member of a consolidated group that joins another consolidated group.

(ii) *Acquiring group.* The term *acquiring group* means a consolidated group that has acquired a former member of another consolidated group (that is, an acquired member).

(iii) *Amended carryback CNOL.* The term *amended carryback CNOL* means the portion of a CNOL attributable to an acquired member (determined pursuant to §1.1502-21(b)(2)(iv)(B)) arising in a taxable year to which amended carryback rules apply.

(iv) *Amended carryback rules.* The term *amended carryback rules* means the rules of section 172 of the Code after amendment by statute to extend the carryback period for NOLs attributable to an acquired member (determined pursuant to §1.1502-21(b)(2)(iv)(B)).

(v) *Amended statute split-waiver election.* The term *amended statute split-waiver election* means, with respect to any amended carryback CNOL, an irrevocable election made by an acquiring group to relinquish the portion of the carryback period (including the default carryback period and the extended carryback period) for that loss during which an acquired member was a member of any former group.

(vi) *Amended statute split-waiver election statement.* The term *amended statute split-waiver election statement* has the meaning provided in paragraph (b)(3)(ii)(C)(5)(i) of this section.

(vii) *Default carryback period.* The term *default carryback period* means the NOL carryback period existing at the time the acquiring group acquired the acquired member, before the applicability of amended carryback rules.

(viii) *Extended carryback period.* The term *extended carryback period* means

the additional taxable years added to a default carryback period by any amended carryback rules.

(ix) *Extended split-waiver election.* The term *extended split-waiver election* means, with respect to any amended carryback CNOL, an irrevocable election made by an acquiring group to relinquish solely the portion of the extended carryback period (and no part of the default carryback period) for that loss during which an acquired member was a member of any former group.

(x) *Extended split-waiver election statement.* The term *extended split-waiver election statement* has the meaning provided in paragraph (b)(3)(ii)(C)(5)(ii) of this section.

(xi) *Former group.* The term *former group* means a consolidated group of which an acquired member previously was a member.

(3) *Conditions for making an amended statute split-waiver election or an extended split-waiver election.* An acquiring group may make an amended statute split-waiver election or an extended split-waiver election (but not both) with respect to an amended carryback CNOL only if—

(i) The acquiring group has not filed a valid election described in §1.1502-21(b)(3)(ii)(B) with respect to the acquired member on or before the effective date of amended carryback rules;

(ii) The acquiring group has not filed a valid election described in section 172(b)(3) and §1.1502-21(b)(3)(i) with respect to a CNOL of the acquiring group from which the amended carryback CNOL is attributed to the acquired member;

(iii) Any other corporation joining the acquiring group that was affiliated with the acquired member immediately before the acquired member joined the acquiring group is included in the waiver; and

(iv) A former group does not claim any carryback (as provided in paragraph (b)(3)(ii)(C)(4) of this section) to any taxable year in the carryback period (in the case of an amended statute split-waiver election) or in the extended carryback period (in the case of an extended split-waiver election) with respect to the amended carryback CNOL on a return or other filing filed on or before the date the acquiring group files the election.

(4) *Claim for a carryback.* For purposes of paragraph (b)(3)(ii)(C)(3)(iv) of this section, a carryback is claimed with respect to an amended carryback CNOL if there is a claim for refund, an amended return, an application for a tentative carryback adjustment, or any other filing that claims the benefit of the NOL in a taxable year prior to the taxable year of the loss, whether or not subsequently revoked in favor of a claim based on the period provided for in the amended carryback rules.

(5) *Procedures for making an amended statute split-waiver election or an extended split-waiver election—(i) Amended statute split-waiver election.* An amended statute split-waiver election must be made in a separate statement entitled “THIS IS AN ELECTION UNDER SECTION 1.1502-21T (b)(3)(ii)(C)(1) TO WAIVE THE PRE-[insert first day of the first taxable year for which the acquired member was a member of the acquiring group] CARRYBACK PERIOD FOR THE CNOLS ATTRIBUTABLE TO THE [insert taxable year of losses] TAXABLE YEAR(S) OF [insert names and employer identification numbers of members]” (amended statute split-waiver election statement). This statement must be filed as provided in paragraph (b)(3)(ii)(C)(6) of this section.

(ii) *Extended split-waiver election.* An extended split-waiver election must be made in a separate statement entitled “THIS IS AN ELECTION UNDER SECTION 1.1502-21T (b)(3)(ii)(C)(1) TO WAIVE THE PRE-[insert first day of the first taxable year for which the acquired member was a member of the acquiring group] EXTENDED CARRYBACK PERIOD FOR THE CNOLS ATTRIBUTABLE TO THE [insert taxable year of losses] TAXABLE YEAR(S) OF [insert names and employer identification numbers of members]” (extended split-waiver election statement). This statement must be filed as provided in paragraph (b)(3)(ii)(C)(6) of this section.

(6) *Time and manner for filing statement—(i) In general.* Except as otherwise provided in paragraph (b)(3)(ii)(C)(6)(ii) or (iii) of this section, an amended statute split-waiver election statement or extended split-waiver election statement must be filed with the acquiring group’s timely filed consolidated return (including

extensions) for the year during which the amended carryback CNOL is incurred.

(ii) *Amended returns.* This paragraph (b)(3)(ii)(C)(6)(ii) applies if the date of the filing required under paragraph (b)(3)(ii)(C)(6)(i) of this section is not at least 150 days after the date of the statutory amendment to the carryback period referred to in paragraph (b)(3)(ii)(C)(2)(iv) of this section. Under this paragraph (b)(3)(ii)(C)(6)(ii), an amended statute split-waiver election statement or extended split-waiver election statement may be attached to an amended return filed by the date that is 150 days after the date of the statutory amendment referred to in paragraph (b)(3)(ii)(C)(2)(iv) of this section.

(iii) *Certain taxable years beginning before January 1, 2021.* This paragraph (b)(3)(ii)(C)(6)(iii) applies to taxable years beginning before January 1, 2021, for which the date of the filing required under paragraph (b)(3)(ii)(C)(6)(i) of this section precedes July 3, 2023. Under this paragraph (b)(3)(ii)(C)(6)(iii), an amended statute split-waiver election statement or extended split-waiver election statement may be attached to an amended return filed by July 3, 2023.

(D) *Examples.* The following examples illustrate the rules of paragraph (b)(3)(ii)(C) of this section. For purposes of these examples: all affiliated groups file consolidated returns; all corporations are includible corporations that have calendar taxable years; each of P, X, and T is a corporation having one class of stock outstanding; each of P and X is the common parent of a consolidated group (P Group and X Group, respectively); neither the P Group nor the X Group includes an insolvent financial institution or an insurance company; no NOL is a farming loss; there are no other relevant NOL carrybacks to the X Group’s consolidated taxable years; except as otherwise stated, the X Group has sufficient consolidated taxable income determined under §1.1502-11 (CTI) to absorb the stated NOL carryback by T; T has sufficient SRLY register income within the X Group to absorb the stated NOL carryback by T; all transactions occur between unrelated parties; and the facts set forth the only relevant transactions.

(1) *Example 1: Computation and absorption of amended carrybacks—(i) Facts.* In Year 1, T became a member of the X Group. On the last day of Year 5, P acquired all the stock of T from X. At the time

of P's acquisition of T stock, the default carryback period was zero taxable years. The P Group did not make an irrevocable split-waiver election under §1.1502-21(b)(3)(ii)(B) to relinquish, with respect to all CNOLs attributable to T while a member of the P Group, the portion of the carryback period for which T was a member of the X Group (that is, a former group). In Year 7, the P Group sustained a \$1,000 CNOL, \$600 of which was attributable to T pursuant to §1.1502-21(b)(2)(iv)(B). In that year, P did not make an irrevocable general waiver election under section 172(b)(3) and §1.1502-21(b)(3)(i) with respect to the \$1,000 CNOL when the P Group filed its consolidated return for Year 7. In Year 8, legislation was enacted that amended section 172 to require a carryback period of five years for NOLs arising in a taxable year beginning after Year 5 and before Year 9.

(ii) *Analysis.* As a result of the amended carryback rules enacted in Year 8, the P Group's \$1,000 CNOL in Year 7 must be carried back to Year 2. Therefore, T's \$600 attributed portion of the P Group's Year 7 CNOL (that is, T's amended carryback CNOL) must be carried back to taxable years of the X Group. See §§1.1502-21(b)(1) and 1.1502-21(b)(2)(i). To the extent T's amended carryback CNOL is not absorbed in the X Group's Year 2 taxable year, the remaining portion must be carried to the X Group's Year 3, Year 4, and Year 5 taxable years, as appropriate. See id. Any remaining portion of T's amended carryback CNOL is carried to consolidated return years of the P Group. See §1.1502-21(b)(1).

(2) *Example 2: Amended statute split-waiver election—(i) Facts.* The facts are the same as in paragraph (b)(3)(ii)(D)(1)(i) of this section (*Example 1*), except that, following the change in statutory carryback period in Year 8, the P Group made a valid amended statute split-waiver election under paragraph (b)(3)(ii)(C) of this section to relinquish solely the carryback of T's amended carryback CNOL.

(ii) *Analysis.* Because the P Group made a valid amended statute split-waiver election, T's amended carryback CNOL is not eligible to be carried back to any taxable years of the X Group (that is, a former

group). However, the amended statute split-waiver election does not prevent T's Year 7 amended carryback CNOL from being carried back to years of the P group (that is, the acquiring group) during which T was a member. See paragraph (b)(3)(ii)(C)(2)(v) of this section. As a result, the entire amount of T's amended carryback CNOL is eligible to be carried back to taxable Year 6 of the P Group. Any remaining CNOL may then be carried over within the P Group. See §1.1502-21(b)(1).

(3) *Example 3: Computation and absorption of extended carrybacks—(i) Facts.* The facts are the same as in paragraph (b)(3)(ii)(D)(1)(i) of this section (*Example 1*), except that the X Group had \$300 of CTI in Year 4 and \$200 of CTI in Year 5 and, at the time of the P Group's acquisition of T, the default carryback period was two years. Therefore, T's \$600 attributed portion of the P Group's Year 7 CNOL was required to be carried back to the X Group's Year 5 taxable year, and the X Group was able to offset \$200 of CTI in Year 5.

(ii) *Analysis.* As a result of the amended carryback rules, the X Group must offset its \$300 of CTI in Year 4 against T's amended carryback CNOL. See §§1.1502-21(b)(1) and (b)(2)(i). The remaining \$100 (\$600 - \$300 - \$200) of T's amended carryback CNOL is carried to taxable years of the P Group. See §1.1502-21(b)(1).

(4) *Example 4: Extended split-waiver election—(i) Facts.* The facts are the same as in paragraph (b)(3)(ii)(D)(3)(i) of this section (*Example 3*), except that, following the change in law in Year 8, the P Group made a valid extended split-waiver election under paragraph (b)(3)(ii)(C) of this section to relinquish the extended carryback period for T's amended carryback CNOL for years in which T was a member of the X Group.

(ii) *Analysis.* As a result of the P Group's extended split-waiver election, T's amended carryback CNOL is not eligible to be carried back to any portion of the extended carryback period (that is, any taxable year prior to Year 5). See paragraph (b)(3)(ii)(C)(2)(ix) of this section. As a result, the X Group absorbs \$200 of T's \$600 loss in Year 5, and the

remaining \$400 (\$600 - \$200) is carried to taxable years of the P Group. See §1.1502-21(b)(1).

(iii) For further guidance, see §1.1502-21(b)(3)(iii).

(iv) and (v) [Reserved]

(c) For further guidance, see §1.1502-21(c) through (h)(8).

(d) through (j) [Reserved]

(h)(1) through (8) [Reserved]

(9) *Amended carryback rules—(i) Applicability date.* Paragraphs (b)(3)(ii)(C) and (D) of this section apply to any CNOLs arising in a taxable year ending after July 2, 2020. However, taxpayers may apply paragraphs (b)(3)(ii)(C) and (D) of this section to any CNOLs arising in a taxable year beginning after December 31, 2017.

(ii) *Expiration date.* The applicability of paragraphs (b)(3)(ii)(C) and (D) of this section will expire on June 30, 2023.

## PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b), the entry for §1.1502-21T is revised to read as follows:

§602.101 OMB Control Numbers.

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
1.1502.21T .....	1545-0123

Douglas W. O'Donnell  
Acting Deputy Commissioner for  
Services and Enforcement.

Approved: June 23, 2020  
David J. Kautter  
Assistant Secretary of the Treasury  
(Tax Policy).

(Filed by the Office of the Federal Register on July 2, 2020, 4:15 p.m., and published in the issue of the Federal Register for July 8, 2020, 85 F.R. 40892)

# Part III

## Notice 2020-53

### I. PURPOSE

In response to the ongoing Coronavirus Disease 2019 (COVID-19) pandemic, this notice provides temporary relief from certain requirements under § 42 of the Internal Revenue Code (Code) for qualified low-income housing projects and under §§ 142(d) and 147(d) of the Code for qualified residential rental projects. Section IV of this notice describes the Agencies, Issuers, Operators, and Owners eligible for the relief granted in section V of this notice, which provides relief pursuant to § 7508A(a) of the Code, and section VI of this notice, which provides relief pursuant to § 1.42-13(a) of the Income Tax Regulations. In this notice, the terms “Agency,” “Issuer,” “Operator,” and “Owner” have the same meanings as described in section 5 of Rev. Proc. 2014-49, 2014-37 I.R.B. 535, or section 4 of Rev. Proc. 2014-50, 2014-37 I.R.B. 540.

### II. BACKGROUND

#### A. Qualified low-income housing projects

Section 42(a) provides that the amount of the low-income housing credit for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building.

Section 42(c)(1)(A) provides that the qualified basis of any qualified low-income building for any taxable year is an amount equal to (i) the applicable fraction (determined as of the close of the taxable year) of (ii) the eligible basis of the building (determined under § 42(d)(4)). Sections 42(c) and 42(d) define applicable fraction and eligible basis. Section 42(d)(1) and (2) define the eligible basis of a new building and an existing building, respectively.

Section 42(c)(2) defines a qualified low-income building as any building which is part of a qualified low-income housing project at all times during the “compliance period” (that is, the period of 15 taxable years beginning with the first

taxable year of the credit period) and to which the amendments made by section 201(a) of the Tax Reform Act of 1986 (Pub. L. No. 99-514) apply. To qualify as a low-income housing project, one of the § 42(g) minimum set-aside tests, as elected by the taxpayer, must be satisfied.

Under § 42(d)(4)(A) and (B), the eligible basis for a qualified low-income building includes the adjusted basis of the property (of a character subject to the allowance of depreciation) used in common areas or provided as comparable amenities to all residential rental units in the building.

Section 42(e) provides general rules under which rehabilitation expenditures incurred by taxpayers related to a low-income building may be treated as a separate new building. Under § 42(e)(3)(A)(ii), to qualify as a separate new building, the rehabilitation expenditures with respect to a low-income building during a 24-month period (§ 42(e) 24-month minimum rehabilitation expenditure period) must be at least the greater of two statutory criteria.

Section 42(g) sets forth three alternative minimum set-aside tests for low-income housing projects. The Owner of a project must elect one and satisfy that chosen test each taxable year. Once a taxpayer elects to use a particular set-aside test, the election is irrevocable.

Section 42(h)(1)(E) provides general rules for carryover allocations of the low-income housing credit. A carryover allocation is defined in § 1.42-6(a)(1) of the Income Tax Regulations as an allocation that meets the requirements of § 42(h)(1)(E) (relating to carryover allocations for single buildings) or § 42(h)(1)(F) (relating to carryover allocations for multiple building projects).

Under § 42(h)(1)(E)(i), if a qualified building is placed in service not later than a statutorily specified date, the building is relieved of a requirement concerning the timing of the allocation. Section 42(h)(1)(E)(ii) provides in part, for purposes of § 42(h)(1)(E)(i), that the term “qualified building” means any building which is part of a project if the taxpayer’s basis in the project (as of the date that is 1 year after the date that the allocation was made) is more than 10 percent of the taxpayer’s

reasonably expected basis in the project (as of the close of the second calendar year following the calendar year in which an allocation is made) (10-percent test).

In general, under § 42(j)(1), if (1) a building is beyond the first year of the credit period, and (2) at the end of the taxable year, the building’s qualified basis with respect to the taxpayer is less than the qualified basis with respect to the taxpayer at the end of the preceding taxable year, then the credits, if any, for the year of the reduction are determined using the reduced qualified basis, and the taxpayer’s Federal income tax liability for the year of the reduction is increased by the credit recapture amount prescribed in § 42(j)(2).

Section 42(j)(4)(E) provides generally that a building is not subject to recapture by reason of a casualty loss to the extent the loss is restored by reconstruction or replacement within a reasonable period established by the Secretary of the Treasury or his delegate (Secretary).

Section 42(m)(1) requires an Agency to allocate housing credit dollar amounts among candidate proposed housing projects. The allocation must be pursuant to a qualified allocation plan (QAP) that has been approved by the governmental unit of which the Agency is a part. A QAP not only sets forth selection criteria by which an Agency makes these allocations but also provides a procedure that the Agency must follow in monitoring for noncompliance with the provisions of § 42, including monitoring for noncompliance with habitability standards through regular site visits.

Section 1.42-5 provides the general requirements of Agencies’ compliance-monitoring responsibilities under their monitoring procedures that must be part of any QAPs. Among the requirements, an Agency must perform physical inspections and low-income certification review.

Section 1.42-5(c)(1)(iii) requires, generally, that the Owner of a low-income housing project certify at least annually to the Agency that, for the preceding 12-month period, the Owner has received an annual income certification from each low-income tenant, and the documentation to support that certification.

Under § 1.42-13(a), the Secretary may provide guidance to carry out the purposes of § 42 through various publications in the Internal Revenue Bulletin.

#### B. Qualified residential rental projects financed by bonds

Generally, under § 103 of the Code, private activity bonds that are not qualified bonds within the meaning of § 141 of the Code are not tax-exempt. Section 141(e) provides in part that the term “qualified bond” means any private activity bond if such bond is an exempt facility bond, and § 142(a) provides in part that the term “exempt facility bond” means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide qualified residential rental projects. To be a qualified residential rental project, a residential rental housing project must meet the requirements in § 142(d).

Section 142(d)(1) provides that the term “qualified residential rental project” means any project for residential rental property if, at all times during the qualified project period, such project meets the requirements under § 142(d)(1)(A) or (B) (§ 142(d) set-aside requirements), whichever is elected by the Issuer at the time of the issuance of the issue with respect to such project.

Section 142(d)(2)(A) provides that the term “qualified project period” means the period beginning on the first day on which 10 percent of the residential units in the project are occupied and ending on the latest of (i) the date that is 15 years after the date on which 50 percent of the residential units in the project are occupied, (ii) the first day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or (iii) the date on which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

Rev. Proc. 2004-39, 2004-2 C.B. 49, sets forth procedures for determining whether a residential rental project complies with the applicable § 142(d) set-aside requirements during the qualified project period. Under section 5.02 of Rev. Proc. 2004-39, for a period of up to

12 months beginning on the issue date of bonds issued to acquire an existing residential rental project (12-month transition period), a failure to satisfy the § 142(d) set-aside requirements will not cause the acquired project to fail to be a qualified residential rental project.

Section 147(d)(1) provides, with certain exceptions, that a private activity bond shall not be a qualified bond if issued as part of an issue and any portion of the net proceeds of such issue is to be used for the acquisition of any property (or an interest therein) unless the first use of such property is pursuant to such acquisition. The private activity bonds to which § 147(d) applies include bonds to finance qualified residential rental projects.

Section 147(d)(2) provides that § 147(d)(1) shall not apply with respect to any building (and the equipment therefor) if the rehabilitation expenditures with respect to such building, equal or exceed 15 percent of the portion of the cost of acquiring such building (and equipment) financed with the net proceeds of the issue.

Section 147(d)(3)(C) provides that the term “rehabilitation expenditures” shall not include any amount which is incurred after the date 2 years after the later of (i) the date on which the building was acquired, or (ii) the date on which the bond was issued (§ 147(d) 2-year rehabilitation expenditure period).

#### C. Postponement of certain deadlines by reason of Presidential declared disasters

Section 7508A provides the Secretary with authority to postpone the time for performing certain acts under the internal revenue laws for a taxpayer determined by the Secretary to be affected by a Federally declared disaster as defined in § 165(i) (5)(A). Pursuant to § 7508A(a), a period of up to one year may be disregarded in determining whether the performance of certain acts is timely under the internal revenue laws.

On March 13, 2020, the President of the United States issued an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act), 42 U.S.C. 5121 et seq., in response to the ongoing COVID-19

pandemic (Emergency Declaration).<sup>1</sup> The Emergency Declaration instructed the Secretary of the Treasury “to provide relief from tax deadlines to Americans who have been adversely affected by the COVID-19 emergency, as appropriate, pursuant to 26 U.S.C. 7508A(a).” Subsequent to the Emergency Declaration, the President issued major disaster declarations under the authority of the Stafford Act with respect to all 50 States, the District of Columbia, and 5 territories (Major Disaster Declarations).<sup>2</sup>

In the context of a Presentially-declared Major Disaster, Rev. Proc. 2014-49 provides temporary relief from certain requirements of § 42 for Agencies and Owners of low-income housing projects. Under section 8 of Rev. Proc. 2014-49, in the case of a casualty loss suffered due to a Major Disaster that has reduced a low-income building’s qualified basis, the Agency that has jurisdiction over the building must determine what constitutes a reasonable restoration period. The reasonable restoration period established by the Agency must not extend beyond the end of the 25th month following the close of the month of the Major Disaster declaration (25-month reasonable restoration period).

Rev. Proc. 2014-49 also provides emergency housing relief for individuals who are displaced by a Major Disaster from their principal residences in certain Major Disaster Areas. See Rev. Proc. 2014-49, sections 12–14.

In the context of a Presentially-declared Major Disaster, Rev. Proc. 2014-50 provides temporary relief from certain requirements under § 142(d) for qualified residential rental projects financed with exempt facility bonds issued by State and local governments under § 142. Rev. Proc. 2014-50 also provides emergency housing relief for individuals who are displaced by a Major Disaster from their principal residences in certain Major Disaster Areas. See Rev. Proc. 2014-50, sections 5–7.

### III. NOTICE 2020-23 AND RELIEF UNDER SECTION 42

On April 9, 2020, the Department of the Treasury and the Internal Revenue Service issued Notice 2020-23, 2020-18 I.R.B.

<sup>1</sup>See <https://www.whitehouse.gov/wp-content/uploads/2020/03/LetterFromThePresident.pdf>.

<sup>2</sup>See <https://www.fema.gov/coronavirus/disaster-declarations>.

742, which provided certain relief to affected taxpayers and postponed due dates until July 15, 2020, with respect to certain tax filings and payments, certain time-sensitive government actions, and all time-sensitive actions listed in Rev. Proc. 2018-58, 2018-

50 I.R.B. 990 (Dec. 10, 2018), that were due to be performed on or after April 1, 2020, and before July 15, 2020. *See Notice 2020-23 and Rev. Proc. 2018-58.* Among the relief granted, Notice 2020-23 (referencing Rev. Proc. 2018-58) postponed until

July 15, 2020, the time to perform certain time-sensitive actions for purposes of § 42 that are due to be performed on or after April 1, 2020, and before July 15, 2020. These time-sensitive actions listed in Rev. Proc. 2018-58 include, among others:

<b>Statute or Regulation</b>	<b>Act Postponed</b>
§ 42(h)(1)(E) and (F)	The taxpayer's basis in the building project, as of the date which is one year after the date that the allocation was made, must be more than 10 percent of the taxpayer's reasonably expected basis in the project.
§ 42(e)(3)(A)(ii)	The taxpayer has a 24-month measuring period in which the requisite amount of rehabilitation expenditures has to be incurred in order to qualify for treatment as a separate new building.
§ 1.42-5(c)	The taxpayer must make certain certifications at least annually to the Agency.

Rev. Proc. 2018-58, section 15, 2018-50 IRB at 1015.

Thus, in addition to other postponements (including other postponements for purposes of § 42 listed in Rev. Proc. 2018-58), Notice 2020-23 postponed until July 15, 2020, the time to perform the following time-sensitive actions for purposes of § 42 that are due to be performed on or after April 1, 2020, and before July 15, 2020:

- The 10-percent test under § 42(h)(1)(E)(ii);
- The 24-month minimum rehabilitation expenditure period under § 42(e); and
- The income recertification requirement under § 1.42-5(c)(1)(iii).

#### IV. SCOPE OF THE RELIEF GRANTED IN THIS NOTICE

Sections V.A through E and VI.A through D of this notice apply to low-income housing projects under § 42, to qualified residential rental projects under § 142(d), and to Agencies, Issuers, Owners, and Operators that have responsibilities with respect to those projects. Section V.F of this notice applies to bonds for qualified residential rental projects that would be qualified bonds (as defined in § 141(e)) if the requirements of § 147(d)(2) were satisfied. The persons described in this section IV have been determined by the Secretary to be persons affected by the COVID-19 emergency for the purposes of the relief described in section V of this notice. In addition, the recipients of relief described in section VI of this

notice have been determined by the Secretary to be sufficiently affected by the COVID-19 pandemic to merit the relief that is provided here under the authority of § 1.42-13(a).

#### V. GRANT OF RELIEF PURSUANT TO SECTION 7508A

##### A. THE 10-PERCENT TEST FOR CARRYOVER ALLOCATIONS

For purposes of § 42(h)(1)(E)(ii), if the last day for an Owner of a building with a carryover allocation to meet the 10-percent test is on or after April 1, 2020, and before December 31, 2020, the last day for the Owner to meet the 10-percent test is postponed to December 31, 2020.

##### B. THE § 42(e) 24-MONTH MINIMUM REHABILITATION EXPENDITURE PERIOD

For purposes of § 42(e)(3)(A)(ii), if the 24-month minimum rehabilitation expenditure period for a building originally ends on or after April 1, 2020, and before December 31, 2020, the last day for the Owner to incur the minimum rehabilitation expenditures with respect to the building is postponed to December 31, 2020.

##### C. REASONABLE PERIOD FOR RESTORATION OR REPLACEMENT IN THE EVENT OF CASUALTY LOSS

For purposes of § 42(j)(4)(E), if a low-income building has suffered a ca-

sualty loss and the reasonable period to restore by reconstruction or replacement ends on or after April 1, 2020, and before December 31, 2020, the last day for the Owner of the building to restore the loss by reconstruction or replacement is postponed to December 31, 2020.

##### D. REASONABLE RESTORATION PERIOD IN THE EVENT OF PRIOR MAJOR DISASTER

For purposes of section 8.02 of Rev. Proc. 2014-49, if a low-income building, due to a prior Major Disaster, has suffered a casualty loss that would have reduced its qualified basis and if the reasonable restoration period determined by the Agency for the building ends on or after April 1, 2020, and before December 31, 2020, the last day for the Owner of the building to complete the repair and restoration is postponed to December 31, 2020.

##### E. THE 12-MONTH TRANSITION PERIOD TO MEET SET-ASIDES FOR QUALIFIED RESIDENTIAL RENTAL PROJECTS

For purposes of section 5.02 of Rev. Proc. 2004-39, the last day of a 12-month transition period for a qualified residential rental project that ends on or after April 1, 2020, and before December 31, 2020, is postponed to December 31, 2020.

## F. THE § 147(d) 2-YEAR REHABILITATION EXPENDITURE PERIOD FOR BONDS USED TO PROVIDE QUALIFIED RESIDENTIAL RENTAL PROJECTS

If a bond is used to provide a qualified residential rental project and if the § 147(d) 2-year rehabilitation expenditure period for the bond ends on or after April 1, 2020, and before December 31, 2020, the last day of that period is postponed to December 31, 2020.

## VI. GRANT OF RELIEF PURSUANT TO § 1.42-13(a)

### A. INCOME RECERTIFICATIONS

An Owner of a low-income building is not required to perform income recertifications under § 1.42-5(c)(1)(iii) in the period beginning on April 1, 2020, and ending on December 31, 2020. The Owner must resume the income recertifications as due under § 1.42-5(c)(1)(iii) after December 31, 2020.

### B. COMPLIANCE-MONITORING

For purposes of § 1.42-5, an Agency is not required to conduct compliance-monitoring inspections or reviews in the period beginning on April 1, 2020, and ending on December 31, 2020. The Agency must re-

sume compliance-monitoring inspections or reviews as due under § 1.42-5 after December 31, 2020.

### C. COMMON AREAS AND AMENITIES

If an amenity or common area in a low-income building or project is temporarily unavailable or closed during some or all of the period from April 1, 2020 to December 31, 2020, in response to the COVID-19 pandemic, and not because of other noncompliance for § 42 purposes, this temporary closure does not result in a reduction of the eligible basis of the building.

### D. EMERGENCY HOUSING FOR MEDICAL PERSONNEL AND OTHER ESSENTIAL WORKERS

If individuals who are medical personnel or other essential workers (as defined by State or local governments) provide services during the COVID-19 pandemic, then, for purposes of providing emergency housing from April 1, 2020, to December 31, 2020, under Rev. Proc. 2014-49 or under Rev. Proc. 2014-50, Agencies, Issuers, Owners, and Operators of low-income housing projects may treat these individuals as if they were Displaced Individuals (defined under section 5.02 of Rev. Proc. 2014-49 or Section 4.04 of Rev. Proc.

2014-50, as applicable). That is, Agencies, Issuers, Owners, and Operators may provide emergency housing for these individuals pursuant to the provisions of the applicable revenue procedure. *See* sections 12, 13, and 14 of Rev. Proc. 2014-49 and sections 5, 6, and 7 of Rev. Proc. 2014-50.

## VII. EFFECTIVE DATE

This notice is effective as of July 1, 2020.

## VIII. EFFECT ON OTHER DOCUMENTS

Notice 2020-23, Rev. Proc. 2004-39, Rev. Proc. 2014-49, and Rev. Proc. 2014-50 are amplified.

## IX. DRAFTING INFORMATION

The principal authors of this notice are Dillon Taylor and Michael J. Torruella Costa, Office of the Associate Chief Counsel (Passthroughs and Special Industries), and Timothy L. Jones and David White, Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Dillon Taylor or Michael J. Torruella Costa at (202) 317-4137 (not a toll-free number); contact Timothy L. Jones or David White at (202) 317-6980 (not a toll-free number).

## Part IV

### Notice of Proposed Rulemaking

#### Credit for Carbon Oxide Sequestration

**REG-112339-19**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations regarding the credit for carbon oxide sequestration under section 45Q of the Internal Revenue Code (Code). These proposed regulations will affect persons who physically or contractually ensure the capture and disposal of qualified carbon oxide, use of qualified carbon oxide as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, or utilization of qualified carbon oxide in a manner that qualifies for the credit.

**DATES:** Written or electronic comments and requests for a public hearing must be received by August 3, 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](http://www.regulations.gov) (indicate IRS and REG-112339-19) 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-

ted electronically, and to the extent practicable on paper, to its public docket.

Send paper submissions to: CC:PA:LP-D:PR (REG-112339-19), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Maggie Stehn of the Office of Associate Chief Counsel (Passthroughs & Special Industries) at (202) 317-6853; concerning submissions of comments and/or requests for a public hearing, Regina L. Johnson at (202) 317-5177 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 45Q of the Code (proposed regulations).

Section 45Q was enacted on October 3, 2008, by section 115 of Division B of the Energy Improvement and Extension Act of 2008, Public Law 110-343, 122 Stat. 3765, 3829, to provide a credit for the sequestration of carbon oxide. On February 17, 2009, section 45Q was amended by section 1131 of Division B of the American Recovery and Reinvestment Tax Act of 2009, Public Law 111-5, 123 Stat 115, 325. Section 45Q was further amended on December 19, 2014, by section 209(j)(1) of Division A of the Tax Increase Prevention Act of 2014, Public Law 113-295, 128 Stat. 4010, 4030, and most recently on February 9, 2018, by section 41119 of Division D of the Bipartisan Budget Act of 2018 (BBA), Public Law 115-123, 132 Stat. 64, 162, to encourage the construction and use of carbon capture and sequestration projects.

On May 20, 2019, the IRS published Notice 2019-32, 2019-21 I.R.B. 1187. The notice requested general comments on issues arising under section 45Q, as well as specific comments concerning secure geological storage, the measurement of qualified carbon oxide, the recapture

of the benefit of the credit for carbon oxide sequestration, the types of utilization that qualify for the credit, the beginning of construction, partnership arrangements, definitions of terms, and other issues related to the credit. The IRS received 116 comments from industry participants, environmental groups, and other stakeholders.

In response to comments submitted pursuant to Notice 2019-32, on March 9, 2020, the Treasury Department and the IRS published Revenue Procedure 2020-12, 2020-11 I.R.B. 511, and Notice 2020-12, 2020-11 I.R.B. 495. Revenue Procedure 2020-12 provides a safe harbor under which the IRS will treat partnerships as properly allocating the section 45Q credit in accordance with section 704(b). Notice 2020-12 provides guidance on the determination of when construction has begun on a qualified facility or on carbon capture equipment that may be eligible for the section 45Q credit.

As requested by commenters, the safe harbor in Revenue Procedure 2020-12 and the rules in Notice 2020-12 are similar to those provided in prior guidance.

Pursuant to section 45Q(h), the Secretary of the Treasury or his delegate (Secretary) may prescribe such regulations and other guidance as may be necessary or appropriate to carry out section 45Q, including regulations or other guidance to (i) ensure proper allocation under section 45Q(a) for qualified carbon oxide captured by a taxpayer during the taxable year ending after the date of the enactment of the BBA, and (ii) determine whether a facility satisfies the requirements under section 45Q(d)(1).

#### Summary of Comments and Explanation of Provisions

##### 1. General Credit Provisions

###### a. Credit Amount in General

Section 45Q(a)(1) allows a credit of \$20 per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility before the date of the enactment of the BBA

(February 9, 2018); (ii) disposed of by the taxpayer in secure geological storage; and (iii) neither used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project nor utilized in a manner described in section 45Q(f)(5).

Section 45Q(a)(2) allows a credit of \$10 per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility before February 9, 2018; and (ii) either (A) used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of by the taxpayer in secure geological storage; or (B) utilized by the taxpayer in a manner described in section 45Q(f)(5).

Section 45Q(a)(3) allows a credit of the applicable dollar amount (as determined under section 45Q(b)(1)) per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018, during the 12-year period beginning on the date the equipment was originally placed in service; (ii) disposed of by the taxpayer in secure geological storage; and (iii) neither used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project nor utilized in a manner described in section 45Q(f)(5).

Section 45Q(a)(4) allows a credit of the applicable dollar amount (as determined under section 45Q(b)(1)) per metric ton of qualified carbon oxide (i) captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018, during the 12-year period beginning on the date the equipment was originally placed in service; and (ii) either (A) used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of by the taxpayer in secure geological storage, or (B) utilized by the taxpayer in a manner described in section 45Q(f)(5).

Section 45Q(b)(1)(A)(i)(I) and (ii)(I) provides that the applicable dollar amount for activities under section 45Q(a)(3) for any taxable year beginning in a calendar year (1) after 2016 and before 2027 is an amount equal to the dollar amount es-

tablished by linear interpolation between \$22.66 and \$50 for each calendar year during such period, and (2) after 2026 is an amount equal to the product of \$50 and the inflation adjustment factor for such calendar year determined under section 43(b)(3)(B) for such calendar year, determined by substituting “2025” for “1990.”

Section 45Q(b)(1)(A)(i)(II) and (ii)(II) provides that the applicable dollar amount for activities under section 45Q(d)(4) for any taxable year beginning in a calendar year (1) after 2016 and before 2027 is an amount equal to the dollar amount established by linear interpolation between \$12.83 and \$35 for each calendar year during such period, and (2) after 2026 is an amount equal to the product of \$35 and the inflation adjustment factor for such calendar year determined under section 43(b)(3)(B) for such calendar year, determined by substituting “2025” for “1990.” Section 45Q(b)(1)(B) provides that the applicable dollar amount determined under section 45Q(b)(1)(A) is rounded to the nearest cent.

Section 45Q(b)(2) provides a method to compute the amount of qualified carbon oxide captured at a qualified facility that was placed in service before February 9, 2018, and for which additional carbon capture equipment is placed in service on or after February 9, 2018. For purposes of section 45Q(a)(1)(A) and (2)(A), the amount of qualified carbon oxide that is captured by the taxpayer is equal to the lesser of (i) the total amount of qualified carbon oxide captured at such facility for the taxable year, or (ii) the total amount of the carbon dioxide capture capacity of the carbon capture equipment in service at such facility on February 8, 2018 (the day before the date of enactment of the BBA). For purposes of section 45Q(a)(3)(A) and (4)(A), the amount of qualified carbon oxide captured by the taxpayer is an amount (not less than zero) equal to the excess of (i) the total amount of qualified carbon oxide captured at such facility for the taxable year, over (ii) the total amount of the carbon dioxide capture capacity of the carbon capture equipment in service at such facility on February 8, 2018. These proposed regulations explain the difference between a physical modification or equipment addition that results in an increase in the carbon dioxide capture capacity of existing

carbon capture equipment, which will be treated as newly placed in service, and a mere increase in the amount of carbon dioxide captured by existing carbon capture equipment, which will not be treated as newly placed in service.

Pursuant to section 45Q(b)(3), a taxpayer may elect to have the dollar amounts applicable under section 45Q(a)(1) or (2) apply in lieu of the dollar amounts applicable under section 45Q(a)(3) or (4) for each metric ton of qualified carbon oxide which is captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018. These proposed regulations provide that the election will apply to all metric tons of qualified carbon oxide captured by the taxpayer at the qualified facility for the full 12-year credit period.

Section 45Q(f)(6)(A) provides that for any taxable year in which an applicable facility captures not less than 500,000 metric tons of qualified carbon oxide, the person described in section 45Q(f)(3)(A)(ii) may elect to have such applicable facility, and any carbon capture equipment placed in service at such applicable facility, deemed as having been placed in service on February 9, 2018. The term “applicable facility” means a qualified facility (i) which was placed in service before February 9, 2018, and (ii) for which no taxpayer claimed a section 45Q credit for any taxable year ending before February 9, 2018.

Section 45Q(f)(7) provides that in the case of any taxable year beginning in a calendar year after 2009, there is substituted for each dollar amount contained in section 45Q(a)(1) and (2) an amount equal to the product of (i) such dollar amount, multiplied by (ii) the inflation adjustment factor for such calendar year determined under section 43(b)(3)(B) for such calendar year, determined by substituting “2008” for “1990.”

Section 45Q(g) provides that in the case of any carbon capture equipment placed in service before February 9, 2018, the section 45Q credit applies with respect to qualified carbon oxide captured using such equipment before the end of the calendar year in which the Secretary, in consultation with the Administrator of the Environmental Protection Agency (EPA), certifies that a total of 75,000,000 metric

tons of qualified carbon oxide have been taken into account in accordance with former section 45Q(a) (as in effect before February 9, 2018) and sections 45Q(a)(1) and (2).

These proposed regulations reflect the statutory provisions relating to credit amounts.

*b. Contractually Ensuring Capture and Disposal, Injection, or Utilization of Qualified Carbon Oxide*

Section 45Q(f)(3)(A)(i) provides that in the case of qualified carbon oxide captured using carbon capture equipment which is originally placed in service at a qualified facility before February 9, 2018, the section 45Q credit is attributable to the person that captures and physically or contractually ensures the disposal through secure geological storage (referred to as disposal), use for tertiary injection and disposal through secure geological storage (referred to as injection) or utilization in a manner consistent with section 45Q(f)(5) (referred to as utilization).

Section 45Q(f)(3)(A)(ii) provides that in the case of qualified carbon oxide captured using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018, the section 45Q credit is attributable to the person that owns the carbon capture equipment and physically or contractually ensures the capture and disposal, injection, or utilization of such qualified carbon oxide.

Commenters requested that the Treasury Department and the IRS clarify which contract provisions are necessary to contractually ensure the capture and disposal, injection, or utilization of qualified carbon oxide. Several commenters requested broad guidance on commercially reasonable terms rather than specifying exact language. One commenter requested guidance regarding the assurance of capture, remedies, guarantees, and the prevention of leakage.

In response, the proposed regulations provide a framework for the types of contracts, terms, and reporting requirements that will demonstrate the contractual assurance of the capture and disposal, injection, or utilization of qualified carbon oxide. The proposed regulations

provide that a taxpayer may enter into multiple contracts with multiple parties for the disposal, injection, or utilization of qualified carbon oxide. For example, a taxpayer that captures qualified carbon oxide may contract with one party to dispose of a portion of its captured qualified carbon oxide in a deep saline formation, with another party to use another portion of its captured qualified carbon oxide as a tertiary injectant in multiple enhanced oil recovery (EOR) sites, and with several parties to utilize the remaining portion of its captured qualified carbon oxide. The existence of each contract and the parties involved must be reported to the IRS on an annual basis on Form 8933, *Carbon Oxide Sequestration Credit* (or successor forms, or pursuant to instructions and other guidance). For contracts for the disposal of carbon oxide or use as a tertiary injectant in enhanced oil or natural gas recovery, the following information must be included: identifying information (name of operator, field, unit and reservoir), the location (county and state) and the identification number assigned to the facility by the EPA's electronic Greenhouse Gas Reporting Tool (e-GGRT ID number). The e-GGRT ID number will allow the IRS to reconcile information with data reported to the EPA's Greenhouse Gas Reporting Program (GHGRP) and otherwise receive technical assistance from the EPA.

The proposed regulations require taxpayers to contractually ensure the disposal, injection, or utilization of qualified carbon oxide in a binding written contract that includes commercially reasonable terms that provides for enforcement. The proposed regulations provide that taxpayers may include information regarding how much carbon oxide the parties agree to dispose of, inject, or utilize in their contracts. Contracts may also include various other specific provisions relating to enforcement, such as long-term liability provisions, indemnity provisions, or penalties for breach of contract or liquidated damages. While the proposed regulations require that the contract include a mechanism for enforcement, no specific enforcement-related provision, or other particular kind of enforcement provision, are mandated by these proposed regulations. This is consistent with allowing contracting parties to

tailor their agreements to a wide variety of business needs and circumstances.

Under the proposed regulations, a taxpayer does not elect to allow all or a portion of the section 45Q credit to any of the contracting parties merely by contracting with that party to ensure the disposal, injection, or utilization of qualified carbon oxide. Any election to allow all or a portion of the credit to another taxpayer must be made separately in the manner provided in these proposed regulations.

*c. Election to Allow the Credit to Another Taxpayer*

Section 45Q(f)(3)(B) provides that a person that is entitled to claim the credit under section 45Q(f)(3)(A)(i) or section 45Q(f)(3)(A)(ii) may elect to allow the person that disposes of the qualified carbon oxide, utilizes the qualified carbon oxide, or uses the qualified carbon oxide as a tertiary injectant to claim the credit (section 45Q(f)(3)(B) election).

Commenters requested guidance regarding the section 45Q(f)(3)(B) election. Commenters generally sought to maximize the ability of the taxpayer to whom the section 45Q credit is attributable (electing taxpayer) to make the section 45Q credit allowable to one or more other taxpayers (credit claimants) pursuant to the section 45Q(f)(3)(B) election. Commenters also generally requested that guidance provide that section 45Q(f)(3)(B) elections may be made on an annual basis. One commenter requested that guidance provide for a broader range of permissible credit claimants, including an owner, operator, service company, supplier, partner, or tax equity or other project finance participant.

One commenter suggested that the section 45Q(f)(3)(B) election should be made in the taxable year that the qualified carbon oxide is disposed of, utilized, or used as a tertiary injectant. The commenter recommended that the election procedures follow the procedures for making a section 338(h)(10) election. Further, commenters suggested that Forms 8933 should be filed by all parties to the section 45Q(f)(3)(B) election with their respective tax returns for the taxable year in which the qualifying activity is completed.

Other commenters suggested that a taxpayer should make a section 45Q(f)(3)(B) election for a taxable year by attaching a statement to a timely filed income tax return (including extensions) for the taxable year. Further, commenters suggested that a taxpayer should be permitted to make a section 45Q(f)(3)(B) election for a portion of the section 45Q credit. The portion allowed to a credit claimant would be specified in the electing taxpayer's annual election as a percentage of the total credit claimed.

One commenter noted that when a taxpayer makes a section 45Q(f)(3)(B) election, the electing taxpayer should no longer claim the section 45Q credit subject to the election. To ensure compliance with this rule, the commenter suggested that the guidance and the relevant tax forms (i.e., Form 8933) require coordination between the electing taxpayer and the credit claimant. For example, the credit claimant could be required to include a copy of the electing taxpayer's section 45Q(f)(3)(B) election to allow the credit.

In response to these comments, the proposed regulations provide guidance regarding who may make a section 45Q(f)(3)(B) election and the time and manner for making a section 45Q(f)(3)(B) election. The proposed regulations also provide that section 45Q(f)(3)(B) elections must be made on an annual basis no later than the time prescribed by law (including extensions) for filing the Federal income tax return or Form 1065 and may not be made on an amended Federal income tax return. However, a section 45Q(f)(3)(B) election may be made on an amended Federal income tax return, an amended Form 1065 or an administrative adjustment request under section 6227 of the Code (AAR), for any taxable year ending after February 9, 2018, but not for taxable years beginning after June 2, 2020.

The proposed regulations also set forth information to be provided as part of a section 45Q(f)(3)(B) election, requiring both an electing taxpayer and a credit claimant to include a Form 8933 (or successor forms, or pursuant to instructions and other guidance) with its timely filed Federal income tax return or Form 1065, U.S. Return of Partnership Income (including extensions) as applicable. An electing taxpayer must provide each credit claim-

ant with a copy of the electing taxpayer's Form 8933, and each credit claimant must attach that copy of the electing taxpayer's Form 8933 to its own Form 8933.

The proposed regulations further provide that section 45Q(f)(3)(B) elections may be made for all or a portion of the available section 45Q credit and may be made for a single or multiple credit claimants. If an electing taxpayer elects to allow multiple credit claimants to claim section 45Q credits, the proposed regulations provide that the maximum amount of section 45Q credits allowable to each credit claimant is proportional to the amount of qualified carbon oxide disposed of, utilized, or used as a tertiary injectant by the credit claimant. In addition, as provided in Revenue Procedure 2020-23, 2020-18 I.R.B.1 (April 27, 2020), the exception applies regarding the time to file an amended return by a partnership subject to the centralized partnership audit regime enacted as part of the BBA (BBA partnership) for the 2018 and 2019 taxable years. The amended Federal income tax return or the amended Form 1065 must be filed, in no event, later than the applicable period of limitations on assessment for the taxable year for which the amended Federal income tax return or Form 1065 is being filed. In the case of a BBA partnership that chooses not to file an amended Form 1065 as permitted under Revenue Procedure 2020-23, the BBA partnership may make a late election by filing an AAR on or before October 15, 2021, but in no event, later than the applicable period of limitations on making adjustments under section 6235 for the reviewed year, as defined in §301.6241-1(a)(8) of the Procedure and Administration Regulations (26 CFR Part 301).

#### d. Amended Returns

Taxpayers may claim section 45Q credits on an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, for taxable years beginning on or after February 9, 2018, provided that the requirements described in the proposed regulations are satisfied. In addition, as provided in Revenue Procedure 2020-23, the exception applies regarding the time to file an amended return by a BBA partnership for the 2018

and 2019 taxable years. The amended Federal income tax return or the amended Form 1065 must be filed, in no event, later than the applicable period of limitations on assessment for the taxable year for which the amended Federal income tax return or Form 1065 is being filed. In the case of a BBA partnership that chooses not to file an amended Form 1065 as permitted under Revenue Procedure 2020-23, the BBA partnership may make a late election by filing an AAR on or before October 15, 2021, but in no event, later than the applicable period of limitations on making adjustments under section 6235 for the reviewed year, as defined in §301.6241-1(a)(8) of the Procedure and Administration Regulations (26 CFR Part 301). However, section 45Q(f)(3)(B) elections may not be made on amended returns for taxable years beginning after the date of issuance of these proposed regulations.

## 2. Definitions

### a. Qualified Carbon Oxide

Section 45Q(c) provides that "qualified carbon oxide" means (A) any carbon dioxide which (i) is captured from an industrial source by carbon capture equipment which is originally placed in service before February 9, 2018; (ii) would otherwise be released into the atmosphere as industrial emission of greenhouse gas or lead to such release; and (iii) is measured at the source of capture and verified at the point of disposal, injection, or utilization; (B) any carbon dioxide or other carbon oxide which (i) is captured from an industrial source by carbon capture equipment which is originally placed in service on or after February 9, 2018; (ii) would otherwise be released into the atmosphere as industrial emission of greenhouse gas or lead to such release; and (iii) is measured at the source of capture and verified at the point of disposal, injection, or utilization; or (C) in the case of a direct air capture facility, any carbon dioxide which (i) is captured directly from ambient air; and (ii) is measured at the source of capture and verified at the point of disposal, injection, or utilization.

While "qualified carbon oxide" includes the initial deposit of captured

carbon oxide used as a tertiary injectant, section 45Q(c)(2) provides that the term does not include carbon oxide that is re-captured, recycled, and re-injected as part of the qualified enhanced oil or natural gas recovery process. Additionally, section 45Q(f)(1) provides that the section 45Q credit applies only with respect to qualified carbon oxide the capture and disposal, injection, or utilization of which is within the United States (within the meaning of section 638(1)), or a possession of the United States (within the meaning of section 638(2)).

Commenters suggested generally that the statutory definition of qualified carbon oxide is sufficient, and did not seek additional clarification. The Treasury Department and the IRS agree that the statutory definition of qualified carbon oxide is clear due to the broad acceptance and use of the term by industry participants, environmental groups, and stakeholders. Therefore, the proposed regulations generally conform to the statutory definition of qualified carbon oxide, including the provision that only qualified carbon oxide captured and disposed of, injected, or utilized within the United States or a possession of the United States is taken into account. Therefore, the proposed regulations generally conform to the statutory definition of qualified carbon oxide, including the provision that only qualified carbon oxide captured and disposed of, injected, or utilized within the United States or a possession of the United States is taken into account.

#### b. Carbon Capture Equipment

Section 45Q does not define carbon capture equipment. One commenter suggested that carbon capture equipment be broadly defined as, “any system that but for its presence and application, the carbon oxides captured at a qualifying industrial facility and on which a section 45Q credit is earned would have been vented into the atmosphere.” Another commenter suggested that the definition allow for maximum flexibility to encompass a complete configuration of equipment including separate units, processing units, processing plants, pipe, buildings, pumps, compressors, meters, facilities, motors, fixtures, materials, and machinery, and all

other improvements used for the purpose of: (1) separating and/or capturing carbon dioxide that would otherwise be released into the atmosphere from a qualifying facility; (2) compressing or otherwise increasing the pressure of carbon dioxide; or (3) transporting, disposing, injecting, and/or utilizing qualified carbon oxide.

Finally, some commenters suggested that the definition of carbon capture equipment should be limited to the equipment that functions to capture the carbon oxides from any industrial source. The commenters explained that once the carbon oxides are captured, equipment having a separate function such as compression, liquefaction, transportation, or pumping, should not be included in the definition of carbon capture equipment.

The Treasury Department and the IRS agree that carbon capture equipment generally should be defined in terms of its functionality. The proposed regulations provide that in general, carbon capture equipment includes all components of property that are used to capture or process carbon oxide until the carbon oxide is transported for disposal, injection, or utilization. Further, the proposed regulations list specific items that are included in, or excluded from the definition of carbon capture equipment. Components of property related to the function of capturing carbon oxides, such as components of property necessary to compress, treat, process, liquefy, or pump carbon oxides, are included within the definition of carbon capture equipment. Components of property related to transporting carbon oxides for disposal, injection, or utilization are not included in the general definition.

#### c. Qualified Facility

Section 45Q(d) provides that “qualified facility” means any industrial facility or direct air capture facility, the construction of which begins before January 1, 2024, and (i) the construction of carbon capture equipment begins before such date; or (ii) the original planning and design for such facility includes installation of carbon capture equipment. In addition, a qualified facility must capture: (i) in the case of a facility which emits not more than 500,000 metric tons of carbon oxide into

the atmosphere during the taxable year, not less than 25,000 metric tons of qualified carbon oxide during the taxable year which is utilized in a manner described in section 45Q(f)(5) (Section 45Q(d)(2)(A) Facility); (ii) in the case of an electricity generating facility which is not a Section 45Q(d)(2)(A) Facility (Section 45Q(d)(2)(B) Facility), not less than 500,000 metric tons of qualified carbon oxide during the taxable year; or (iii) in the case of a direct air capture facility or any facility which is not a Section 45Q(d)(2)(A) Facility or a Section 45Q(d)(2)(B) Facility, not less than 100,000 metric tons of qualified carbon oxide during the taxable year.

Some commenters requested that the proposed regulations incorporate the “80/20 Rule” set forth in Rev. Rul. 94-31, 1994-1 C.B. 16, which held that for section 45 purposes a facility that contains some used property would still qualify as originally placed in service, provided the fair market value of the used property is not more than 20 percent of the facility’s total value. Commenters requested the inclusion of this rule because the section 45Q credit amounts depend on whether carbon capture equipment is placed in service before February 9, 2018, or on or after that date.

The proposed regulations adopt the 80/20 Rule and provide that a qualified facility or carbon capture equipment may qualify as originally placed in service even though it contains some used components of property, provided the fair market value of the used components of property is not more than 20 percent of the qualified facility or carbon capture equipment’s total value (the cost of the new components of property plus the value of the used components of property). For purposes of the 80/20 Rule, the cost of a new qualified facility or carbon capture equipment includes all properly capitalized costs of the new qualified facility or carbon capture equipment. Solely for purposes of the 80/20 Rule, properly capitalized costs of a new qualified facility or carbon capture equipment may, at the option of the taxpayer, include the cost of new equipment for a pipeline owned and used exclusively by that taxpayer to transport carbon oxides captured from that taxpayer’s qualified facility that would otherwise be emitted into the atmosphere.

#### d. Industrial Facility

Section 45Q does not define the term “industrial facility.” Commenters suggested that an “industrial facility” should be defined as a facility that produces a carbon oxide stream from a fuel combustion source, a manufacturing process, or a fugitive carbon oxide-emission source that, absent capture and disposal, injection, or utilization, would otherwise be released into the atmosphere. They also recommended that the term not include a facility that produces carbon dioxide through carbon dioxide production wells at natural carbon dioxide-bearing formations. This definition is consistent with the definition of industrial facility provided in section 3.03 of Notice 2020-12. The proposed regulations adopt this definition.

#### e. Direct Air Capture Facility

Section 45Q(e)(1) provides that the term “direct air capture facility” means any facility which uses carbon capture equipment to capture carbon dioxide directly from the ambient air, except the term does not include any facility which captures carbon dioxide that is deliberately released from naturally occurring subsurface springs or using natural photosynthesis.

Generally, commenters did not request that the definition of “direct air capture facility” be clarified. One commenter suggested that “direct air capture facility” include certain algae. Although section 45Q(f)(5)(A)(i) provides that photosynthesis or chemosynthesis is a permitted type of utilization of qualified carbon oxide, the statutory definition of a “direct air capture facility” excludes any facility that captures carbon dioxide using natural photosynthesis. Therefore, the proposed regulations do not adopt the commenter’s suggestion.

#### 3. Secure Geological Storage

Section 45Q(f)(2) provides that the Secretary, in consultation with the Administrator of the EPA, the Secretary of Energy, and the Secretary of the Interior, must establish regulations for determining adequate security measures for the geological storage of qualified carbon oxide

under section 45Q(a) such that the qualified carbon oxide does not escape into the atmosphere. Such term includes storage at deep saline formations, oil and gas reservoirs, and unminable coal seams under such conditions as the Secretary may determine under such regulations.

Injection of carbon oxide into any underground reservoir, onshore or offshore under submerged lands within the territorial jurisdiction of States, requires the operator to comply with Underground Injection Control (UIC) program regulations and to obtain the appropriate UIC well permits. Under 40 CFR §146.5 (Classification of injection wells) Class II may be an appropriate UIC well permit for wells which inject fluids (including carbon dioxide) brought to the surface in connection with conventional oil or natural gas production and may be commingled with waste waters from gas plants that are an integral part of production operations, unless those fluids are classified as a hazardous waste at the time of injection, and for wells which inject fluids (including carbon oxides) for enhanced recovery of oil or natural gas. Class VI is an appropriate UIC well permit for wells that are not experimental in nature that are used for geologic sequestration of carbon dioxide beneath the lowermost formation containing an underground source of drinking water; or, for wells used for geologic sequestration of carbon dioxide that have been granted a waiver of the injection depth requirements pursuant to requirements at 40 CFR §146.95; or, for wells used for geologic sequestration of carbon dioxide that have received an expansion to the areal extent of an existing Class II enhanced oil recovery or enhanced gas recovery aquifer exemption pursuant to §§146.4 and 144.7(d) of 40 CFR.

Operators that inject carbon dioxide underground are also subject to the EPA’s GHGRP requirements set forth at 40 CFR Part 98. Under 40 CFR Part 98 subpart RR (Geologic Sequestration of Carbon Dioxide source category, referred to as *subpart RR*), certain facilities, including UIC Class VI wells, are required to report basic information on carbon dioxide received for injection, develop and implement an EPA-approved site-specific Monitoring, Reporting, and Verification Plan (MRV Plan), and report the amount of carbon

dioxide geologically sequestered using a mass balance approach and annual monitoring activities. Under 40 CFR Part 98 subpart UU (Injection of Carbon Dioxide source category, referred to as *subpart UU*), all other facilities that inject carbon dioxide underground such as for EOR or any other purpose, are required to report basic information on carbon dioxide received for injection. Facilities that conduct EOR are not required by 40 CFR Part 98 to report under subpart RR unless (1) the owner or operator chooses to opt into subpart RR or, (2) the facility holds a UIC Class VI permit for the well or group of wells used for EOR. Annual reports that are submitted under 40 CFR Part 98 to the EPA’s GHGRP undergo verification by the EPA, and non-confidential data from these reports are published on the EPA’s website.

Commenters noted that Form 8933 defines “secure geological storage” for purposes of section 45Q as requiring approval by the EPA of an MRV Plan. Thus, meeting the Form 8933 conditions would be achieved currently by receiving either (i) a UIC Class VI permit plus an EPA-approved MRV Plan, which UIC Class VI permit holders are already required to have because they are subject to subpart RR; or (ii) a UIC Class II permit plus an EPA-approved MRV Plan. The Form 8933 requirement that UIC Class II permit holders receive an approved MRV Plan for purposes of the section 45Q credit creates an additional burden on such holders. Some commenters expressed concern that being required to opt into subpart RR may create a misalignment with state mineral property and natural resource conservation laws, as well as accepted industry practices and commercial arrangements. Therefore, the commenters generally requested that the Treasury Department and the IRS provide alternatives to opting into subpart RR for demonstrating secure geological storage for EOR projects.

Many commenters suggested that a standard adopted by the International Organization for Standardization (ISO) and endorsed by the American National Standards Institute (ANSI), CSA/ANSI ISO 27916:19, “Carbon Dioxide Capture, Transportation and Geological Storage – Carbon Dioxide Storage Using Enhanced Oil Recovery (CO<sub>2</sub>-EOR),” is a viable

alternative to subpart RR for establishing secure geological storage for the use of qualified carbon oxide for EOR.

The CSA/ANSI ISO 27916:19 standard was developed for the purpose of quantifying and documenting the total carbon dioxide that is stored in association with EOR. In general, reporting under CSA/ANSI ISO 27916:19 uses mass balance accounting, has established reporting and documentation requirements, and includes requirements for documenting a monitoring program and a containment assurance plan.

Some of the commenters advocating for the application of the CSA/ANSI ISO 27916:19 standard emphasized the importance and need for public acceptance and input, transparent public filings, credible third-party audits and certifications, and government oversight and enforcement. For example, some commenters suggested that the proposed regulations require that all relevant documentation of the amount of qualified carbon oxide stored for purposes of the section 45Q credit be retained and made available for public review and the total quantity of qualified carbon oxide stored for long-term containment be reported annually. The Treasury Department and the IRS appreciate the importance of shared and open information in this context and encourage transparency. However, there is no statutory requirement in section 45Q for taxpayers, Federal agencies, or industry groups to publicly display this information or otherwise make it available. In addition, the IRS is itself limited in what it can disclose because of the rules prohibiting the public disclosure of taxpayer information under section 6103.

Some commenters also requested that the Treasury Department and the IRS recognize the standards for secure geological storage required by government entities with regulatory primacy, and also recommended that states be allowed to certify the secure geological storage of qualified carbon oxide. The commenters noted that the EPA has approved primary enforcement authority (primacy) for UIC Class II wells for more than half the states. Primacy permits a state, tribe, or territory to implement and oversee its own EPA approved program. One commenter requested that the IRS clarify that a valid UIC

Class VI permit issued under the authority of the EPA includes permits issued by a state that has received final approval from the EPA of its primacy application under section 1422 of the Safe Water Drinking Act to implement a Class VI UIC Program. The commenter also suggested that use of an accounting methodology consistent with the mass balance equation under subpart RR be adequate to establish secure geological storage.

The Treasury Department and the IRS, in consultation with the EPA, DOE, and the Department of Interior (Interior Department), agree that providing CSA/ANSI ISO 27916:19 as an alternative for UIC Class II wells is a viable quantification methodology that is appropriate for these purposes. Both subpart RR and CSA/ANSI ISO 27916:19 require an assessment and monitoring of potential leakage pathways; quantification of inputs, losses and storage through a mass balance approach; and documentation of steps and approaches. Operators of UIC Class II wells that follow the CSA/ANSI ISO 27916:19 standard could elect to report to the EPA's GHGRP under subpart RR but would not be required to do so. Rather, they could continue to report to the EPA under subpart UU.

The Treasury Department and the IRS, in consultation with the EPA, DOE, and the Interior Department, disagree with suggestions to allow the reporting rules promulgated by states as an alternative to subpart RR or CSA/ANSI ISO 27916:19. Reporting rules among states are not uniform and states may have different reporting requirements and different governing bodies to whom carbon dioxide injection projects are required to report. Adopting such rules would not promote uniformity, and would increase the administrative burden on the IRS significantly.

Consequently, the proposed regulations allow the CSA/ANSI ISO 27916:19 standard as an alternative to subpart RR for UIC Class II wells using qualified carbon oxide for EOR, but do not allow standards set by states as an alternative to subpart RR. In addition, the proposed regulations do not provide for an alternative to subpart RR reporting for UIC Class VI wells because all UIC Class VI wells are already subject to subpart RR reporting requirements. A taxpayer that reported volumes

of carbon oxide to the EPA pursuant to subpart RR may self-certify the volume of carbon oxide claimed for purposes of section 45Q. Alternatively, if a taxpayer determined volumes pursuant to CSA/ANSI ISO 27916:19, the taxpayer may prepare documentation as outlined in CSA/ANSI ISO 27916:2019 internally, but such documentation must be provided to a qualified independent engineer or geologist, who then must certify that the documentation provided, including the mass balance calculations as well as information regarding monitoring and containment assurance, is accurate and complete.

#### *4. Utilization of Qualified Carbon Oxide*

Section 45Q(f)(5)(A) provides that “utilization of qualified carbon oxide” means (i) the fixation of such qualified carbon oxide through photosynthesis or chemosynthesis, such as through the growing of algae or bacteria; (ii) the chemical conversion of such qualified carbon oxide to a material or chemical compound in which such qualified carbon oxide is securely stored; or (iii) the use of such qualified carbon oxide for any other purpose for which a commercial market exists (with the exception of use as a tertiary injectant in a qualified enhanced oil or natural gas recovery project), as determined by the Secretary.

Section 45Q(f)(5)(B) provides a methodology to determine the amount of qualified carbon oxide utilized by the taxpayer. Such amount is equal to the metric tons of qualified carbon oxide which the taxpayer demonstrates, based upon an analysis of lifecycle greenhouse gas emissions and subject to such requirements as the Secretary, in consultation with the Secretary of Energy and the Administrator of the EPA, determines appropriate, were (i) captured and permanently isolated from the atmosphere, or (ii) displaced from being emitted into the atmosphere, through use of a process described in section 45Q(f)(5)(A). The term “lifecycle greenhouse gas emissions” has the same meaning given such term under subparagraph (H) of section 211(o)(1) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)), as in effect on February 9, 2018, except that “product” is substituted for “fuel” each place it appears in such subparagraph.

Commenters generally sought guidance about the methodologies required to prepare an acceptable life cycle analysis (LCA) that demonstrates the amount of qualified carbon oxide utilized, as well as the boundaries required for the LCA.

One commenter requested that guidance establish clear guidelines for the preparation of an LCA by applicants to demonstrate the net reduction or avoidance of carbon dioxide achieved through its utilization by the taxpayer. Because LCA requires selection of comparative data, the commenter recommended that the LCA undergo a review by a third party, determined by the IRS, to assess the reasonableness of the assumptions, factors and calculations used by the applicant.

Other commenters suggested using the Greenhouse Gases, Regulated Emissions, and Energy Use in Transportation (GREET) model, or an adaptation of it adopted by the California Air Resources Board, to perform LCA of transportation fuels, and further suggested using both a basic method and a safe harbor method. The GREET model is a tool that examines the life-cycle impacts of vehicle technologies, fuels, products, and energy systems. It provides a transparent platform through which energy and vehicle producers, researchers, and regulators can evaluate energy and environmental effects of vehicle technologies and energy and product systems. For any given energy and vehicle system, GREET can calculate total energy consumption (non-renewable and renewable), emissions of air pollutants, emissions of greenhouse gases, and water consumption.

One commenter suggested that the LCA, as reviewed by the relevant governmental agency, should determine whether any release of embodied qualified carbon oxide is possible for a specific utilization project. If so, the commenter recommended that recapture be addressed in the LCA. The commenter requested guidance regarding the types of LCA models that are appropriate, and recommended the GREET model.

Another commenter suggested that the IRS should not adopt a specific methodology or approach to calculating lifecycle emissions. Instead, the commenter recommended that guidance make clear that models that are acceptable to the EPA

will also be acceptable for purposes of section 45Q. The commenter suggested that the LCA model for section 45Q purposes should be one that is recognized by the EPA based on its use in the Renewable Fuel Standard or other program administered by the EPA. The commenter further recommended that if the capture and utilization of carbon oxides also generates other greenhouse gas detriments, such as an increase in emissions over the base case, those greenhouse gases caused by the utilization should be adjusted to account for the relative global warming potential. Similarly, if the capture and utilization of carbon oxides reduce greenhouse gas emissions over the base case, the commenter argued that those benefits should also be credited.

One commenter sought guidance on the boundaries for LCA to determine displacement of carbon dioxide and recommended that lifecycle emissions include the entirety of the lifecycle.

Several commenters expressed the view that an MRV Plan or any accredited LCA performed by a qualified firm as determined by the IRS could be suitable for establishing boundaries for lifecycle emissions for qualified carbon oxide utilization. Further, commenters suggested that there should be contractual proof to track the supply chain and ensure that the MRV Plan is followed according to the annual LCA.

Some commenters suggested that guidance require EOR operators to provide a full lifecycle greenhouse gas emissions analysis that, like the requirements for utilization, includes all stages of product and feedstock production and distribution, from feedstock generation or extraction through the distribution and delivery and use of the finished product to the ultimate consumer. The commenters requested that the IRS make public all lifecycle emissions calculations.

One commenter made the following suggestions. First, taxpayers should use an independent consulting firm or other similar independent entity to undertake the LCA. Second, taxpayers should insure that an LCA model is realistic and has been used widely by the LCA industry. Third, an LCA must be commercially available to anyone and must be able to be examined in any audit by the IRS.

Fourth, taxpayers should use an LCA that compares a base case of making the product produced by utilization without carbon capture to the modeled utilization case using qualified carbon oxide to determine what greenhouse gases were displaced from being emitted into the atmosphere. Finally, taxpayers must use an LCA which models all “greenhouse gases” as defined in the Clean Air Act in determining the net impact of such greenhouse gases generated or reduced in utilization of qualified carbon oxide.

One commenter suggested that the IRS should provide a safe harbor for taxpayers that retain a third-party firm to undertake the LCA. However, the commenter stated that while a safe harbor would be helpful, third-party verification should not be mandatory, as many taxpayers may have sufficient engineering expertise in-house and some smaller projects may not support the extra cost of third-party verification.

In response to the commenters, the proposed regulations conform the definition of utilization to the statutory definition. The Treasury Department and the IRS, in consultation with the EPA and the DOE, concluded that the LCA must be in writing and either performed or verified by a professionally-licensed third party that uses generally-accepted standard practices of quantifying the greenhouse gas emissions of a product or process and comparing that impact to a baseline. In particular, the analysis must contain documentation consistent with the International Organization for Standardization (ISO) 14044:2006, “Environmental management — Life cycle assessment — Requirements and Guidelines,” as well as a statement documenting the qualifications of the third party. Although the section 45Q credit is only available with respect to qualified carbon oxides, all greenhouse gas emissions are taken into account under this analysis. The proposed regulations require a taxpayer to submit an LCA report to the IRS and the DOE. The LCA will be subject to a technical review by the DOE, and the IRS, in consultation with the DOE and the EPA, will determine whether to approve the LCA. The Treasury Department and the IRS request comments on how to achieve consistency in boundaries and baselines so that similarly situated taxpayers will be treated consistently. The Treasury De-

partment and the IRS are willing to consider issuing guidance on particular fact patterns.

The proposed regulations do not define commercial markets or provide for Standards of Lifecycle Analysis. The Treasury Department and the IRS continue to study these issues and request comments.

### 5. Credit Recapture

Section 45Q(f)(4) directs the Secretary to provide regulations for recapturing the benefit of any section 45Q credit allowable with respect to any qualified carbon oxide which ceases to be captured, disposed of, or used as a tertiary injectant in a manner consistent with the requirements of section 45Q.

Commenters sought guidance about the method for measuring the amount of leaked qualified carbon oxide subject to recapture (recapture amount), the method for calculating recapture, and the open period during which a recapture event may occur (recapture period).

All of these issues require a definition of the recapture period. The proposed regulations provide that the *recapture* period begins on the date of the first injection of qualified carbon oxide for disposal in secure geological storage or use as a tertiary injectant and ends the earlier of five years after the last taxable year in which the taxpayer claimed a section 45Q credit or the date monitoring ends under subpart RR requirements or the CSA/ANSI ISO 27916:19 standard.

For clarity we will describe two sub-portions of the recapture period, the “post-credit-claiming period” and the “lookback period”. The “post-credit-claiming period” is the period after the end of the twelve year credit period during which a leak can result in recapture, whereas the “lookback period” is the portion of the recapture period during which the IRS can look back after a leakage event to recapture credits. Most commenters supported a lookback period of three to five years.

Commenters generally suggested that if a recapture event occurs with respect to storage of qualified carbon oxide, then the taxpayer must add the recapture amount to the amount of tax due in the taxable year in which the recapture event occurs, as

opposed to attributing the leak to past tax years and amending those returns.

Commenters also suggested that a recapture event should occur when qualified carbon oxide, for which a section 45Q credit has been allowed, ceases to be stored in secure geological storage if the amount of leakage of qualified carbon oxide in a taxable year exceeds the amount of qualified carbon oxide stored in that same taxable year. In other words, they suggested that a leak would first offset the immediate tax year’s claimed credits and then be an addition to tax, as opposed to auditing and amending past tax returns.

One commenter stated that the standard for measuring recapture of the section 45Q credit should be the mass balance calculations that are used for determining the amount of qualified carbon oxide stored in secure geological storage. The commenter noted that these mass balance calculations effectively establish a last-in/first-out (LIFO) accounting method that assumes current year releases offset current year injections for the qualified carbon oxide that is in secure geological storage.

Several commenters requested a safe harbor for recapture, providing that recapture will not apply so long as the injection operator is operating in compliance with any standards set by the Treasury Department and the IRS for secure geological storage of the qualified carbon oxide. These commenters asserted that if the injection operator is in compliance with the secure geological storage standards at the time of a release, any release or leakage of the qualified carbon oxide would be offset by current year injections of qualified carbon oxide. If the injection operator is not operating in compliance with the standards for secure geological storage at the time of the release, the commenters recommended that any recapture be calculated on a LIFO basis against previously taken section 45Q credits when the injection operator was in compliance with the secure geological storage standards.

The proposed regulations do not provide a recapture safe harbor, but do limit the recapture period similar to the recapture provisions for investment credit property under section 50(a)(1). Specifically, the proposed regulations provide that any recapture amount will be accounted for in the taxable year that it is identified and

reported. If, during the recapture period, a taxpayer, operator, or regulatory agency determines that qualified carbon oxide has leaked to the atmosphere, the taxpayer will have a recapture amount if the leaked amount of qualified carbon oxide exceeds the amount of qualified carbon dioxide disposed of in secure geological storage or used as a tertiary injectant in that taxable year. That excess amount of leaked qualified carbon oxide will be recaptured at a credit rate calculated on a LIFO basis (that is, the excess leaked qualified carbon oxide will be deemed attributable first to the first preceding year, then to second preceding year, and then up to the fifth preceding year) to simplify the calculation of the recapture amount.

The taxpayer must add the amount of the recaptured section 45Q tax credit to the amount of tax due in the taxable year in which the recapture event occurs. Consistent with this five-year lookback period, the proposed regulations provide that the post-credit-claiming period ends the earlier of (i) five years after the last taxable year in which the taxpayer claimed a section 45Q credit or (ii) the date monitoring ends under the requirements of the subpart RR standard or the CSA/ANSI ISO 27916:19 standard.

The proposed regulations also provide that in the event of a recapture event with respect to a secure geological storage location in which the stored qualified carbon oxide had been captured from more than one unit of carbon capture equipment that was not under common ownership, the recapture amount must be allocated among the taxpayers that own the multiple units of carbon capture equipment pro rata on the basis of the amount of qualified carbon oxide captured from each of the multiple units of carbon capture equipment.

Similarly, the proposed regulations provide that in the event of a recapture event where the leaked amount of qualified carbon oxide is deemed attributable to qualified carbon oxide with respect to which multiple taxpayers claimed section 45Q credit amounts, the recapture amount is allocated on a pro rata basis among the taxpayers that claimed the section 45Q credits.

The proposed regulations provide a limited exception to recapture in the event of a leakage of qualified carbon oxide re-

sulting from actions not related to the selection, operation, or maintenance of the storage facility, such as volcanic activity or a terrorist attack. Finally, the proposed regulations provide that if qualified carbon oxide is deliberately removed from a secure storage site, a recapture event occurs in the year in which the qualified carbon oxide is removed from its original storage.

As noted in section 4.08 of Revenue Procedure 2020-12, a taxpayer may obtain third-party recapture insurance to protect against recapture.

The Treasury Department and the IRS request comments on how to apply the recapture provisions to section 45Q credits that are carried forward to future taxable years due to insufficient income tax liability in the current taxable year.

## Effect on Other Documents

Sections 1 through 5 of Notice 2009-83, 2009-2 C.B. 588, as modified by Notice 2011-25, 2011-1 C.B. 604, are obsoleted. The remaining sections of Notice 2009-83 provide reporting and record-keeping requirements associated with the limitation on credits available under former section 45Q(a) (as in effect before February 9, 2018) and sections 45Q(a)(1) and (2). After the end of the calendar year in which the Secretary, in consultation with the Administrator of the EPA, certifies that a total of 75,000,000 metric tons of qualified carbon oxide have been taken into account under former section 45Q(a) (as in effect before February 9, 2018) and sections 45Q(a)(1) and (2), the remaining sections of Notice 2009-83 will be obsoleted.

## Proposed Effective/Applicability Date

The regulations are proposed to apply to taxable years beginning on or after the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. However, taxpayers may choose to apply the final regulations for taxable years beginning on or after February 9, 2018, and before the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**. See section 7805(b)(7). Alternatively, taxpayers

may rely on these proposed regulations for taxable years beginning on or after February 9, 2018, and before the date the Treasury decision adopting these regulations as final regulations is published in the **Federal Register**, provided the taxpayers follow the proposed regulations in their entirety and in a consistent manner.

## Statement of Availability for IRS Documents

For copies of recently issued Revenue Procedures, Revenue Rulings, Notices, and other guidance published in the Internal Revenue Bulletin, please visit the IRS website at <http://www.irs.gov>.

## Special Analyses

### I. Regulatory Planning and Review—Economic Analysis

Executive Orders 13563, 13771, and 12866 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 E.O. 13771 designation is de-regulatory.

These regulations have been designated by the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA) as economically significant under 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.

#### A. Background and Overview

Section 45Q was enacted on October 3, 2008, by section 115 of Division B of the Energy Improvement and Extension Act of 2008, Public Law 110-343, 122 Stat. 3765, 3829, to provide a credit for the sequestration of carbon dioxide. On February 17, 2009, section 45Q was

amended by section 1131 of Division B of the American Recovery and Reinvestment Tax Act of 2009, Public Law 111-5, 123 Stat. 115, 325. Section 45Q was further amended on December 19, 2014, by section 209(j)(1) of Division A of the Tax Increase Prevention Act of 2014, Public Law 113-295, 128 Stat. 4010, 4030, and most recently on February 9, 2018, by section 41119 of Division D of the Bipartisan Budget Act of 2018 (BBA), Public Law 115-123, 132 Stat. 64, 162.

On May 20, 2019, the IRS published Notice 2019-32, 2019-21 I.R.B. 1187. The notice requested general comments on issues arising under section 45Q, as well as specific comments concerning the secure geological storage and measurement of qualified carbon oxide, and the recapture of the benefit of the credit for carbon oxide sequestration. The IRS received 116 comments from industry members, environmental groups, and other stakeholders.

In addition, the Treasury Department and the IRS published Revenue Procedure 2020-12, 2020-11 I.R.B. 511, and Notice 2020-12, 2020-11 I.R.B. 495. Revenue Procedure 2020-12 provides a safe harbor under which the IRS will treat partnerships as properly allocating the section 45Q credit in accordance with section 704(b). Notice 2020-12 provides guidance on the determination of when construction has begun on a qualified facility or on carbon capture equipment that may be eligible for the section 45Q credit.

Section 45Q generally allows a credit of an amount per metric ton of qualified carbon oxide captured by the taxpayer using carbon capture equipment. This qualified carbon oxide must be captured according to the statute in one of three general manners. First, it may be disposed of in secure geological storage. This would occur if it were injected into a geologic formation, such as a deep saline formation, an oil and gas reservoir, or an unminable coal seam.

Second, the qualified carbon oxide may be used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of in secure geological storage. A “tertiary injectant” is qualified carbon oxide that is injected into and stored in a qualified enhanced oil or natural gas recovery project and contributes to the extraction of crude oil or natural gas.

Third, the qualified carbon oxide may be “utilized” by fixing it through photosynthesis or chemosynthesis, converting it to a material or chemical compound in which it is securely stored, or using it for any other purpose for which a commercial market exists. “Utilization” generally means the qualified carbon oxide was captured and permanently isolated from the atmosphere, or displaced from being emitted into the atmosphere. Calculation of the amount utilized is based on an analysis of lifecycle greenhouse gas emissions.

The amount of the credit depends on the date the carbon capture equipment is placed in service and whether the qualified carbon oxide is disposed of in secure storage, injected, or utilized. Different rules and credit amounts apply to qualified carbon oxide capture projects placed in service before and after the date of enactment of the BBA on February 9, 2018. Based on annual reports filed with the IRS as of May, 2019, the aggregate amount of qualified carbon oxide taken into account for purposes of section 45Q was 62,740,171 metric tons. This is an increase of 2,972,247 metric tons from the preceding year.<sup>1</sup> According to data reported to the EPA’s Greenhouse Gas Reporting Program (GHGRP), there were 65 enhanced oil recovery (EOR) projects operating in the U.S. in 2018. As of 2019, the National Petroleum Council, an oil and natural gas advisory committee to the Secretary of Energy, reports that there were 10 carbon capture, utilization, and storage projects in the United States. DOE models project that the section 45Q credit may result in the sequestration of approximately 570 million metric tons of carbon oxides between 2018 and 2036.

#### B. Need for Regulation

The proposed regulations provide guidance regarding the application of section 45Q. Section 45Q requires regulations for determining adequate security measures for the secure geological storage of qualified carbon oxide such that it does not escape into the atmosphere, standards for recapture of section 45Q credits, and standards for carbon oxide utilization.

### C. Economic Analysis

#### 1. Baseline

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

#### 2. Economic Rationale for Issuing Guidance for the 2018 BBA

The Treasury Department and the IRS anticipate that the issuance of guidance pertaining to section 45Q will provide greater clarity in definitions than the alternative of having no further descriptions than the statute; more flexibility in methods to establish qualifications for the credit relative to prior guidance; and more transparency regarding business arrangements related to the section 45Q credit relative to the baseline. These features may lower compliance burden and increase economic investment by lowering regulatory barriers to entry, compared to a baseline of having only the statue and not the regulations.

#### 3. Economic Analysis of Specific Provisions

The final regulations embody certain regulatory decisions that reflect necessary regulatory discretion. These decisions specify more fully how the section 45Q credit is to be implemented.

##### i. Standard for Secure Geological Storage

###### a. Background

Section 45Q(f)(2) provides that the Secretary, in consultation with the Administrator of the EPA, the Secretary of Energy, and the Secretary of the Interior, must establish regulations for determining adequate security measures for the secure geological storage of qualified carbon oxide under section 45Q such that qualified carbon oxide does not escape into the atmosphere. Such term in-

cludes storage at deep saline formations, oil and gas reservoirs, and unminable coal seams under such conditions as the Secretary may determine under such regulations.

Under existing law, injection of carbon dioxide into any underground reservoir requires the operator to comply with EPA’s Underground Injection Control (UIC) program regulations and to obtain the appropriate UIC well permits. The UIC program is designed to protect underground sources of drinking water from underground injection. Operators that inject carbon dioxide underground are also subject to the EPA’s GHGRP requirements set forth at 40 CFR Part 98.

Under 40 CFR Part 98, facilities that inject carbon dioxide underground for long-term containment of carbon dioxide in subsurface geologic formations are specifically subject to 40 CFR Part 98 subpart RR (Geologic Sequestration of Carbon Dioxide source category, referred to as *subpart RR*). Facilities that are subject to subpart RR, including UIC Class VI wells, are required to report basic information on carbon dioxide received for injection, develop and implement an EPA-approved site-specific Monitoring, Reporting, and Verification Plan (MRV Plans); and report the amount of carbon dioxide geologically sequestered using a mass balance approach and annual monitoring activities.

Facilities that inject carbon dioxide underground for the purposes of enhanced oil (EOR) and gas recovery or any other purpose other than geologic sequestration are required to report basic information on carbon dioxide received for injection under 40 CFR Part 98 subpart UU (Injection of Carbon Dioxide source category, referred to as *subpart UU*). At present, the EPA does not generally require facilities that conduct EOR to report under subpart RR. However, the owner or operator may voluntarily choose to opt in to subpart RR. For both subparts RR and UU, annual reports are submitted under 40 CFR Part 98 to the EPA’s GHGRP and undergo verification by the EPA. Non-confidential data from these reports are published on the EPA’s website.

<sup>1</sup>These data are available in Notice 2018-40, 2018-20 I.R.B. 583, and Notice 2019-31, 2019-20 I.R.B. 1181.

## b. Comments Received

Commenters noted that in order to qualify for section 45Q credits, IRS Form 8933 defines “secure geological storage” as requiring approval by the EPA of an MRV Plan under 40 CFR Part 98 subpart RR. Thus, meeting the Form 8933 conditions would currently be achieved by receiving either (i) a UIC Class VI permit plus an EPA-approved MRV Plan, which UIC Class VI permit holders are already required to have because they are subject to subpart RR; or (ii) a UIC Class II permit plus an EPA-approved MRV Plan, which requires UIC Class II permit holders to opt in to subpart RR. In this manner, the Form 8933 requirement that UIC Class II permit holders receive an approved MRV Plan creates an additional burden on such holders because— it requires them to opt in to subpart RR to receive section 45Q credits. In addition, some commenters expressed concern that a requirement that they opt in to subpart RR, in addition to being a supplementary requirement, may create a misalignment with state mineral property and natural resource conservation laws.

Commenters supported the continued use of subpart RR, but most commenters sought an alternative method in addition to subpart RR. Many of these commenters considered the subpart RR requirements burdensome, for the reasons noted immediately above.

Many commenters suggested that a standard adopted by the International Organization for Standardization (ISO) and endorsed by the American National Standards Institute (ANSI), CSA/ANSI ISO 27916:19 standard, “Carbon dioxide capture, transportation and geological storage – Carbon dioxide storage using enhanced oil recovery (CO<sub>2</sub>-EOR),” (CSA/ANSI ISO 27916:19) is a viable alternative to subpart RR for establishing secure geological storage for the use of qualified carbon oxide for EOR.

The CSA/ANSI ISO 27916:19 was developed for the purpose of quantifying and documenting the total carbon dioxide that is stored in association with carbon dioxide-EOR. In general, reporting under CSA/ANSI ISO 27916:19 (i) uses mass balance accounting, (ii) has established reporting and documentation requirements, and (iii) includes requirements for

documenting a monitoring program and a containment assurance plan. ANSI, a not-for-profit organization dedicated to supporting the U.S. voluntary standards and conformity assessment system, adopted the CSA/ANSI ISO 27916:19 standard in 2019.

## c. Regulatory Alternatives and Analysis

The Treasury Department and the IRS considered three options for defining standards for secure geological storage: (i) the requirements set forth in 40 CFR Part 98 subpart RR; (ii) an election for the taxpayer to comply with either the subpart RR standards or the requirements set forth in CSA/ANSI ISO 27916:19 and (iii) other alternatives to subpart RR, including allowing use of state programs.

In evaluating option (ii), the Treasury Department and the IRS, in consultation with the EPA, the DOE, and the Interior Department, agree with commenters that CSA/ANSI ISO 27916:19 is a viable quantification methodology that is adequate for the intent and purpose of the statute. Both subpart RR and CSA/ANSI ISO 27916:19 require an assessment and monitoring of potential leakage pathways; quantification of inputs, losses and storage through a mass balance approach; and documentation of steps and approaches. Under option (ii), operators of UIC Class II wells that follow the CSA/ANSI ISO 27916:19 standard could elect to report under subpart RR but would not be required to do so. Rather, they could continue to report to the EPA under subpart UU.

The Treasury Department and the IRS, in consultation with the EPA, the DOE, and the Interior Department, disagree with commenter suggestions to allow the reporting rules promulgated by states as an alternative to subpart RR or CSA/ANSI ISO 27916:19. Reporting rules among states are not uniform and states may have different reporting requirements and different governing bodies to whom carbon dioxide injection projects are required to report. The adoption of such rules by the Treasury Department and the IRS would substantially increase the administrative burden on the IRS. The Treasury Department and the IRS did not attempt to determine to what extent particular states’ stan-

dards would fulfill the intent and purpose of the statute.

The ability for taxpayers to elect to use the CSA/ANSI ISO 27916:19 standard instead of subpart RR could yield economic differences in three ways. First, if the two standards are different in their costs of compliance, then allowing a choice allows EOR project operators to choose the less costly standard. This would reduce costs of compliance and regulatory burden. Second, to the extent that the difference in compliance costs between the two standards is high and that difference is a significant portion of start-up costs, then allowing a less expensive standard might lead to more investment and more new projects. Third, operators can use the option that best aligns with their project goals and timeframes. The Treasury Department and the IRS project that compliance costs for some taxpayers may be lower under the CSA/ANSI ISO 27916:19 standard than under subpart RR. Some commenters stated that subpart RR may create a misalignment for UIC Class II wells with both state mineral property and natural resource conservation laws; and that such potential misalignment would be costly to taxpayers. This stated misalignment would not be implicated with the use of the ISO standards.

The Treasury Department and the IRS recognize that the two standards differ in terms of who would be responsible for reviewing and approving a sequestration plan and for identifying leakage once a project is in place. In addition, the standards differ because unless otherwise required by law, the CSA/ANSI ISO 27916:19 standard does not require public reports of the amount of qualified carbon oxide sequestered, whereas the subpart RR standard does entail the public provision of such data. The Treasury Department and the IRS did not attempt to analyze the economic consequences of these differences.

The Treasury Department and the IRS did not attempt to provide quantitative estimates of the difference in compliance costs between the CSA/ANSI ISO 27916:19 standard and a regulatory alternative of requiring only subpart RR because suitable data are not readily available at this level of detail. Further, the Treasury Department and IRS did not

attempt to estimate the effects of compliance cost differences on investment or sequestration.

The Treasury Department and the IRS solicit comments on these findings and particularly solicit data, models, or other evidence that could enhance the rigor with which the final regulations are developed.

## ii. Credit Recapture

Section 45Q(f)(4) requires the Treasury Department and the IRS to promulgate regulations to provide for the recapture of section 45Q credits in the event of leakage. “Recapture” refers to the repayment of the tax credits claimed, and not to the capturing of CO<sub>2</sub> that may have leaked from the project after being injected.

In response to Notice 2019-32, 2019-21 I.R.B. 1187, several commenters requested clarification regarding credit recapture, including (i) when the tax would be due in relation to the year of a recapture event, (ii) how long the IRS can “look back” to recapture credits in the event of leakage (lookback period), and (iii) the length of time after ceasing to claim credits during which a leakage event would lead to recapture of credits.

All of these issues require a definition of the recapture period. The proposed regulations provide that the *recapture* period begins on the date of the first injection of qualified carbon oxide for disposal in secure geological storage or use as a tertiary injectant and ends the earlier of five years after the last taxable year in which the taxpayer claimed a section 45Q credit or the date monitoring ends under subpart RR requirements or the CSA/ANSI ISO 27916:19 standard.

For clarity we will describe two sub-portions of the recapture period, the “post-credit-claiming period” and the “lookback period”. The “post-credit-claiming period” is the lesser of 5 years after the last taxable year in which the taxpayer claimed a section 45Q credit or the date monitoring ends under subpart RR requirements or the CSA/ANSI ISO 27916:19 standard. Depending on the project’s individual requirements, the post-credit-claiming period is therefore between zero and five years. Whereas the “lookback period” is the portion of the recapture period during which the IRS can

look back after a leakage event to recapture credits. Most commenters supported a lookback period of three to five years.

A leakage event that leads to recapture of credits can occur any time during the recapture period. A leakage event that occurs after the recapture period would not lead to recapture of credits.

The proposed regulations provide that any recapture amount will be accounted for in the taxable year that it is identified and reported. The amount of credits that can be recaptured in the event of leakage depends on the length of the lookback period and the amount of the leakage.

If, during the recapture period, it is determined that qualified carbon oxide has leaked to the atmosphere, the taxpayer will have a recapture amount if the leaked amount of qualified carbon oxide exceeds the amount of qualified carbon dioxide disposed of in secure geological storage or used as a tertiary injectant in that taxable year. That excess amount of leaked qualified carbon oxide will be recaptured at a credit rate calculated on a LIFO basis (that is, such excess leaked qualified carbon oxide will be deemed attributable first to the first preceding year, then to second preceding year, and so forth up to five years) for ease of administration. The taxpayer must add the amount of the recaptured section 45Q tax credit to the amount of tax due in the taxable year in which the recapture event occurs. This rule applies regardless of whether the project injected qualified carbon oxide in the taxable year.

In response to Notice 2019-32, commenters expressed concerns with how long the length of a lookback period after the project operator stops claiming section 45Q credits (for example, if the project is finished or the period for claiming credits ends) that a leakage event can lead to recapture. Commenters were concerned that investors would deem the risk too high to invest if the end of the recapture period extended too long after the final year of claiming section 45Q credits. To address this concern the proposed regulations provide that the recapture period begins on the date of first injection of qualified carbon oxide for disposal in secure geological storage or use as a tertiary injectant and ends the earlier of five years after the last taxable year in which the taxpayer claimed a section 45Q credit

or the date monitoring ends under subpart RR requirements or the CSA/ANSI ISO 27916:19 standard.

The Treasury Department and the IRS considered alternative specifications for the lookback period other than five years. Open-ended or undefined lookback periods would increase the financial risk associated with the project and dissuade investors, particularly for projects for which the section 45Q credit would constitute a sizeable share of revenue. The proposed regulations, by allowing for a specific and finite lookback period, will encourage more investment in projects relative to an unspecified or infinite period. The Treasury Department and the IRS, in consultation with the EPA, the DOE, and the Interior Department, have determined that for the period after the lookback period, existing environmental regulations and standards will ensure integrity consistent with the intent and purpose of the statute.

In examining possible lookback periods, the Treasury Department and the IRS have not developed a quantitative model to incorporate the costs of monitoring and the probability of leakage along with the tax administration burden involved in the lookback period.

The Treasury Department and the IRS welcome comments on the length of the lookback period and particularly solicit data, models, or other evidence that could enhance the rigor with which the final regulations are developed.

## iii. Utilization of Qualified Carbon Oxide

Section 45Q(f)(5)(A) provides that “utilization of qualified carbon oxide” means (i) the fixation of such qualified carbon oxide through photosynthesis or chemosynthesis, such as through the growing of algae or bacteria; (ii) the chemical conversion of such qualified carbon oxide to a material or chemical compound in which such qualified carbon oxide is securely stored; or (iii) the use of such qualified carbon oxide for any other purpose for which a commercial market exists (with the exception of use as a tertiary injectant in a qualified enhanced oil or natural gas recovery project), as determined by the Secretary.

Section 45Q(f)(5)(B) provides a methodology to determine the amount

of qualified carbon oxide utilized by the taxpayer. Such amount is equal to the metric tons of qualified carbon oxide which the taxpayer demonstrates, based upon an analysis of lifecycle greenhouse gas emissions and subject to such requirements as the Secretary, in consultation with the Secretary of Energy and the Administrator of the EPA, determines appropriate, were (i) captured and permanently isolated from the atmosphere, or (ii) displaced from being emitted into the atmosphere, through use of a process described in section 45Q(f)(5)(A). The term “lifecycle greenhouse gas emissions” has the same meaning given such term under subparagraph (H) of section 211(o)(1) of the Clean Air Act (42 U.S.C. 7545(o)(1)(H)), as in effect on the date of enactment of the BBA on February 9, 2018, except that “product” is substituted for “fuel” each place it appears in such subparagraph.

The term “lifecycle greenhouse gas emissions” means the aggregate quantity of greenhouse gas emissions (including direct emissions and significant indirect emissions such as significant emissions from land use changes), related to the full product lifecycle, including all stages of product and feedstock production and distribution, from feedstock generation or extraction through the distribution and delivery and use of the finished product to the ultimate consumer, where the mass values for all greenhouse gases are adjusted to account for their relative global warming potential.

Commenters proposed multiple methods for the Treasury Department and the IRS to allow for calculating “utilization” of qualified carbon oxide. The proposed regulations provide clarifications regarding: (i) standards for the lifecycle analysis (LCA) of emissions that were captured or displaced for purposes of section 45Q(f)(5)(B); and (ii) the agency with responsibility to review the LCA.

The Treasury Department and the IRS, in consultation with the EPA and the DOE, have determined that the LCA must be in writing and either performed or verified by a professionally-licensed third party that uses generally-accepted standard practices of quantifying the greenhouse gas emissions of a product or process and comparing that impact to a baseline.

In particular, the analysis must contain documentation consistent with the International Organization for Standardization (ISO) 14044:2006, “Environmental management — Life cycle assessment — Requirements and Guidelines,” as well as a statement documenting the qualifications of the third party.

The proposed regulations require a taxpayer submit an LCA report to the IRS and the DOE prior to the taxpayer claiming the section 45Q credit. The LCA will be subject to a technical review by the DOE, and the IRS, in consultation with the DOE and the EPA, will determine whether to approve the LCA.

The proposed regulations provide greater clarity and examples for calculating qualified carbon oxide utilization. This enhanced clarity should increase transparency and lower compliance burden. In addition, the proposed regulations allow for oversight of the LCA plans by a third party, the DOE, and the IRS (in consultation with the DOE and the EPA); evaluation and approval of the plans before the taxpayer claims the credit will potentially reduce taxpayer compliance costs and IRS administrative costs. Following industry-specific standards will also increase clarity in qualifying for the section 45Q credit.

The proposed regulations provide an economic gain arising from enhanced clarity regarding the rules of the section 45Q credit within the context of the intent and purpose of the statute. The Treasury Department and the IRS project that this clarity will encourage additional investment in carbon oxide utilization projects relative to the no-action baseline. The Treasury Department and the IRS have not estimated this gain because we do not have readily available data or models to predict (i) the interpretations that taxpayers might have made in the absence of this guidance, and (ii) the effect of such guidance on the investment that taxpayers would make, relative to alternative regulatory approaches or the no-action baseline.

The Treasury Department and the IRS solicit comments on the economic consequences of these decisions and particularly solicit data, models, or other evidence that could enhance the rigor with which the final regulations are developed.

## II. Paperwork Reduction Act

The collection of information in these proposed regulations with respect to section 45Q are in proposed §1.45Q-1(e), §1.45Q-1(h)(3)(iv), §1.45Q-1(h)(2)(v), and §1.45Q-2(h)(2), §1.45Q-3(d), and §1.45Q-4(c)(1).

The collection of information in proposed §1.45Q-1(e) is an election to have the dollar amounts applicable under §1.45Q-1(b) apply in lieu of the dollar amounts applicable under §1.45Q-1(d) for each metric ton of qualified carbon oxide that a taxpayer captures using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018. A new election must be made for each taxable year that the taxpayer wishes to allow a credit claimant to claim section 45Q credits. The election must be made on a Form 8933 (or successor forms, or pursuant to instructions and other guidance), and applies to all metric tons of qualified carbon oxide captured by the taxpayer at the qualified facility throughout the full 12-year credit period. The IRS is contemplating making additional changes to the Form 8933 to take these proposed regulations into account.

The collection of information in proposed §1.45Q-1(h)(3)(iv) is an election that a taxpayer (electing taxpayer) eligible for the section 45Q credit may make to allow the person that disposes of the qualified carbon oxide, utilizes the qualified carbon oxide, or uses the qualified carbon oxide as a tertiary injectant to claim the credit (credit claimant). The electing taxpayer that makes the section 45Q(f)(3)(B) election must file a statement of election containing the information described in §1.45Q-1(h)(3)(iv) with the electing taxpayer’s Federal income tax return or Form 1065 for each taxable year in which the credit arises. The section 45Q(f)(3)(B) election must be made in accordance with Form 8933 (or successor forms, or pursuant to instructions and other guidance) no later than the time prescribed by law (including extensions) for filing the Federal income tax return for the year in which the credit arises. The election may not be filed with an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, after the prescribed date (including extensions) for filing the original

Federal income tax return or Form 1065 for the year, with the exception of amended Federal income tax returns, amended Forms 1065, or AARs, as applicable, for any taxable year ending after February 9, 2018, and before taxable years beginning after June 2, 2020. New section 45Q(f)(3)(B) elections must be made for each taxable year that the electing taxpayer wishes to allow credit claimants to claim section 45Q credits. The IRS is contemplating making additional changes to the Form 8933 to take these proposed regulations into account.

The collection of information in proposed §1.45Q-1(h)(2)(v) requires that if a taxpayer enters into a binding written contract with a third party that physically carries out the disposal, injection, or utilization of qualified carbon oxide, the existence of each contract and the parties involved must be reported to the IRS annually on a Form 8933 (or successor forms, or pursuant to instructions and other guidance) by each party to the contract, regardless of the party claiming the credit. The IRS is contemplating making additional changes to the Form 8933 to take these proposed regulations into account.

The collection of information in proposed §1.45Q-2(h)(2) requires that a taxpayer that claims a section 45Q credit for qualified carbon oxide that is captured and then used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project certify such qualified enhanced oil or natural gas recovery project as required under §1.43-3. This requires that the taxpayer obtain a petroleum engineer's certification under §1.43-3(a)(3) for each project that must be attached to a Form 8933 (or successor forms, or pursuant to instructions and other guidance) and filed not later than the last date prescribed by law (including extensions) for filing the operator's or designated owner's Federal income tax return or Form 1065 for the first taxable year in which qualified carbon oxide is injected into the reservoir. If a section 45Q credit is claimed on an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, the petroleum engineer's certification will be treated as filed timely if it is attached to a Form 8933 that is submitted with such amended federal income tax return, amended Form 1065,

or AAR. With respect to a section 45Q credit that is claimed on a timely filed Federal income tax return or Form 1065 for a taxable year ending after February 9, 2018 and beginning before June 2, 2020, for which the petroleum engineer's certification was not submitted, the petroleum engineer's certification will be treated as filed timely if it is attached to an amended Form 8933 for any taxable year ending after February 9, 2018, but not for taxable years beginning after June 2, 2020. Additionally, the taxpayer is required to provide an operator's continued certification under §1.43-3(b)(3) for each project that must be attached to a Form 8933 (or successor forms, or pursuant to instructions and other guidance) and filed not later than the last date prescribed by law (including extensions) for filing the operator's or designated owner's Federal income tax return or Form 1065 for taxable years after the taxable year for which the petroleum engineer's certification is filed but not after the taxable year in which injection activity ceases and all injection wells are plugged and abandoned. The IRS is contemplating making additional changes to the Form 8933 to take these proposed regulations into account.

The collection of information in proposed §1.45Q-3(d) requires a taxpayer that claims a section 45Q credit for qualified carbon oxide that is captured and then used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project to certify the volume of carbon oxide claimed for purposes of section 45Q. A taxpayer that reported volumes of carbon oxide to the EPA pursuant to subpart RR may self-certify the volume of carbon oxide claimed for purposes of section 45Q. Alternatively, if the taxpayer determined volumes pursuant to CSA/ANSI ISO 27916:19, a taxpayer may prepare documentation as outlined in CSA/ANSI 27916:2019 internally, but such documentation must be provided to a qualified independent engineer or geologist, who then must certify that the documentation provided, including the mass balance calculations as well as information regarding monitoring and containment assurance is accurate and complete. Taxpayers that capture carbon oxide giving rise to the section 45Q credit must file Form 8933 (or

successor forms, or pursuant to instructions and other guidance) with a timely filed tax return, including extensions. Taxpayers that dispose of, inject, or utilize qualified carbon oxide must also file Form 8933 (or successor forms, or pursuant to instructions and other guidance) with a timely filed

Federal income tax return or Form 1065, including extensions. The IRS is contemplating making additional changes to the Form 8933 to take these proposed regulations into account.

The collection of information in proposed §1.45Q-4(c)(1) requires a taxpayer that utilizes qualified carbon oxide to measure the amount of carbon oxide captured and utilized through a combination of direct measurement and life cycle analysis (LCA). The measurement and written LCA report must be performed by or verified by an independent third party. The report must contain documentation consistent with the International Organization for Standardization (ISO) 14044:2006, "Environmental management — Life cycle assessment — Requirements and Guidelines," as well as a statement documenting the qualifications of the third party, including proof of appropriate professional license or foreign equivalent, and an affidavit from the third-party stating that it is independent from the taxpayer. The taxpayer must submit the written LCA report to the IRS and the DOE. The LCA will be subject to a technical review by the DOE, and the IRS, in consultation with the DOE and the EPA, will determine whether to approve the LCA.

For purposes of the Paperwork Reduction Act of 1995 (51087 U.S.C. 3507(d)) (PRA), the reporting burden associated with proposed §1.45Q-1(e), §1.45Q-1(h)(3)(iv), §1.45Q-1(h)(2)(v), §1.45Q-2(h)(2), §1.45Q-3(d), and §1.45Q-4(c)(1) will be reflected in the IRS Paperwork Reduction Act Submission for the Form 8933 (OMB control numbers 1545-0123 and 1545-2132). The IRS is anticipating making revisions to Form 8933 to take these proposed regulations into account. 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](http://www.irs.gov/draftforms).

The current status of the Paperwork Reduction Act submissions related to the section 45Q credit is provided in the following table. The section 45Q provisions are included in aggregated burden estimates for the OMB control numbers listed below which, in the case of 1545-0123, represents a total estimated burden time, including all other related forms and schedules for corporations, of 3.157 billion hours and total estimated monetized costs of \$58.148 billion (\$2017). The burden estimates provided in the OMB con-

trol numbers are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include but not isolate the estimated burden of only the section 45Q requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the proposed regulations. No burden estimates specific to the proposed regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information

collections, related to the requirements under the proposed regulations. Those estimates would capture both changes made to section 45Q by the BBA and those that arise out of discretionary authority exercised in the proposed regulations. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to the proposed regulations.

When available, drafts of IRS forms are posted for comment at [www.irs.gov/draftforms](http://www.irs.gov/draftforms).

Form	Type of Filer	OMB Number(s)	Status
Form 8933	Business	1545-2132	Sixty-day notice published in the <b>Federal Register</b> on 10/21/19 (84 FR 56283). Public comment period closed on 12/20/19. Thirty-day notice published in the <b>Federal Register</b> on 1/31/20 (85 FR 5776). Public comment period closed on 3/2/20. OIRA approval is pending.
Form 8933	Business (NEW Model)	1545-0123	Sixty-day notice published in the <b>Federal Register</b> on 9/30/19 (84 FR 51718). Public Comment period closed on 11/29/19. Thirty-day notice published in the <b>Federal Register</b> on 12/19/19 (84 FR 69825). Public Comment period closed on 1/21/20. Approved by OIRA on 1/30/20.  Link: <a href="https://hs-www-federalregister-gov.ticky.io/documents/2019/10/21/2019-22844/proposed-collection-comment-request-for-form-8933">https://hs-www-federalregister-gov.ticky.io/documents/2019/10/21/2019-22844/proposed-collection-comment-request-for-form-8933</a>

### III. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and that are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposal is not likely to have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis (IRFA) of the proposed rule. The Treasury Department and the IRS have not determined whether the proposed rule, when finalized, will likely have a significant economic impact on a substantial number of small entities. This determination requires further study. However, because there is a possibility of significant economic impact on a substantial number of small entities, an IRFA is provided in these proposed regulations. The Treasury Department and the

IRS invite comments on both the number of entities affected and the economic impact on small entities.

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

#### 1. Need for and Objectives of the Rule

The proposed regulations will provide greater clarity to taxpayers for purposes of claiming the section 45Q credit for the capture and disposal, injection, or utilization of qualified carbon oxide. The proposed rule is expected to encourage taxpayers to invest in carbon capture technologies. Thus, the Treasury Department and the IRS intend and expect that the proposed rule will deliver benefits across the economy that will beneficially impact various industries and reduce emissions of carbon oxides that would otherwise be released into the atmosphere as industrial emission of greenhouse gasses or lead to such release.

### 2. Affected Small Entities

The Small Business Administration estimates in its 2018 Small Business Profile that 99.9 percent of United States businesses meet its definition of a small business. The applicability of these proposed regulations does not depend on the size of the business, as defined by the Small Business Administration. As described more fully in the preamble to this proposed regulation and in this IRFA, these rules may affect a variety of different businesses across several different industries.

The section 45Q credit incentivizes three different categories of activities related to captured carbon oxide. First, the section 45Q credit is available to taxpayers who capture carbon oxide and dispose of it in secure geological storage. This would occur if it were injected into a geological formation, such as a deep saline formation, an oil and gas reservoir, or an unminable coal seam. The taxpayer claiming the credit for carbon oxide that is securely stored can be either the taxpayer who owns the capture equipment, or if an

election is made, the taxpayer who disposes of the carbon oxide.

Second, the section 45Q credit is also available for carbon oxide captured and used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of in secure geological storage. The taxpayer claiming the credit for carbon oxide that is used as a tertiary injectant in enhanced oil recovery projects can be either the taxpayer who owns the capture equipment, or if an election is made, the taxpayer who uses the carbon oxide as a tertiary injectant in a qualified enhanced oil or natural gas recovery project.

And third, the section 45Q credit is available for carbon oxide “utilized” by fixing it through photosynthesis or chemosynthesis, converted to a material or chemical compound in which it is securely stored, or used for any other purpose for which a commercial market exists. The taxpayer claiming the credit for utilization of carbon oxide can be either the taxpayer who owns the carbon capture equipment, or if an election is made, the taxpayer who utilizes the carbon oxide.

Because the potential credit claimants in all three of these scenarios can vary, including potential tax equity investors from the financial services sector as credit claimants, it is difficult to estimate at this time the impact of these proposed regulations, if any, on small businesses.

The Treasury Department and the IRS expect to receive more information on the impact on small businesses through comments on this proposed rule and again when taxpayers start to claim the section 45Q credit using the guidance and procedures provided in these proposed regulations.

### **3. Impact of the Rule**

The proposed regulations will allow taxpayers to plan investments and transactions based on the ability to claim the section 45Q credit. The increased use of the section 45Q credit may lead to increased investment in infrastructure to transport carbon dioxide, and increased development of carbon capture technologies. In addition, the increased use of the section 45Q credit will incentivize the development of technologies for utilization

of carbon oxide. The recordkeeping and reporting requirements will increase for taxpayers that claim the section 45Q credit. This includes costs associated with the taxpayer filing the Form 8933, as well as required election statements and maintaining records to substantiate carbon capture of carbon oxide, disposal in secure geological storage, use as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposal in secure geological storage, or utilization. Each taxpayer will be required to file a separate Form 8933 for each year that a section 45Q credit is claimed or that an election is made with respect to a section 45Q credit. Although the Treasury Department and the IRS do not have sufficient data to determine precisely the likely extent of the increased costs of compliance, the estimated burden of complying with the recordkeeping and reporting requirements are described in the Paperwork Reduction Act section of the preamble.

### **4. Alternatives Considered**

As described in more detail in the Regulatory Impact Analysis of this preamble, the Treasury Department and the IRS considered alternatives to the proposed regulations. For example, in providing rules related to how to demonstrate secure geological storage in the case of tertiary injection and disposal through secure geological storage, the Treasury Department and the IRS considered whether to (i) require compliance with subpart RR, (ii) allow use of subpart RR or CSA/ANSI ISO 27916:19, or (iii) other alternatives to subpart RR including use of state programs. Commenters to Notice 2019-32, 2019-21 I.R.B. 1187, consistently recommended CSA/ANSI ISO 27916:19 as a potential alternative to subpart RR. The Treasury Department and the IRS, in consultation with the DOE, the EPA and the Interior Department, agreed that, in the case of tertiary injection and disposal through secure geological storage, allowing the use of subpart RR or CSA/ANSI ISO 27916:19 would sufficiently demonstrate secure geological storage for purposes of the statutory requirement, without creating or imposing undue burdens on taxpayers.

### **5. Duplicative, Overlapping, or Conflicting Federal Rules**

The proposed rule would not duplicate, overlap, or conflict with any relevant Federal rules. As discussed above, the proposed rule would merely provide procedures and definitions to allow taxpayers to claim the section 45Q credit. The Treasury Department and the IRS invite input from interested members of the public about identifying and avoiding overlapping, duplicative, or conflicting requirements.

### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “**ADDRESSES**” heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Specifically, in section 4 of the Summary of Comments and Explanation of Provisions, the Treasury Department and the IRS request specific comments on how to achieve consistency in boundaries and baselines so that similarly situated taxpayers will be treated consistently. The Treasury Department and the IRS also request specific comments regarding the definition of commercial markets and standards for Lifecycle Analysis. Additionally, in section 5 of the Summary of Comments and Explanation of Provisions, the Treasury Department and the IRS request specific comments on how to apply the recapture provisions to section 45Q credits that are carried forward to future taxable years due to insufficient income tax liability in the current taxable year.

Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at [www.regulations.gov](http://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 as prescribed in this preamble under the “**DATES**” heading. 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.

#### **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. In 2018, that threshold is approximately \$150 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

#### **V. Executive Order 13132: Federalism**

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

#### **Drafting Information**

The principal author of the proposed regulations is Maggie Stehn of the Office of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and the IRS participated in the development of the proposed regulations.

#### **List of Subjects**

#### **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 1.45Q-1 also issued under 26 U.S.C. 45Q.

Section 1.45Q-2 also issued under 26 U.S.C. 45Q(c), (d), and (e).

Section 1.45Q-3 also issued under 26 U.S.C. 45Q(f)(2).

Section 1.45Q-4 also issued under 26 U.S.C. 45Q(f)(5).

Section 1.45Q-5 also issued under 26 U.S.C. 45Q(f)(4).

\* \* \* \* \*

**Par. 2.** Sections 1.45Q-0, 1.45Q-1, 1.45Q-2, 1.45Q-3, 1.45Q-4, and 1.45Q-5 are added to read as follows:

##### *§1.45Q-0 Table of Contents*

This section lists the captions contained in §§1.45Q-1 through 1.45Q-5.

##### *§1.45Q-1 Credit for Carbon Oxide Sequestration.*

(a) In general.

(b) Credit amount for carbon capture equipment originally placed in service before February 9, 2018.

(c) Credit amount for carbon capture equipment originally placed in service on or after February 9, 2018.

(d) Applicable dollar amount.

(1) Applicable dollar amount for any taxable year beginning in a calendar year after 2016 and before 2027 for qualified carbon oxide not used as a tertiary injectant or utilized.

(2) Applicable dollar amount for any taxable year beginning in a calendar year after 2026 for qualified carbon oxide not used as a tertiary injectant or utilized.

(3) Applicable dollar amount for any taxable year beginning in a calendar year after 2016 and before 2027 for qualified carbon oxide used as a tertiary injectant or utilized.

(4) Applicable dollar amount for any taxable year beginning in a calendar year after 2026 for qualified carbon oxide used as a tertiary injectant or utilized.

(e) Election to apply the \$10 and \$20 credit amounts in lieu of the applicable dollar amounts.

(f) Application of section 45Q for certain carbon capture equipment placed in service before February 9, 2018.

(g) Installation of additional carbon capture equipment.

(1) Allocation of section 45Q credits for facilities installing additional carbon capture equipment.

(2) Additional carbon capture equipment.

(3) New carbon capture equipment.

(4) Examples.

(i) Example 1.

(ii) Example 2.

(iii) Example 3.

(h) Eligibility for the section 45Q credit.

(1) Person to whom the section 45Q credit is attributable.

(i) Equipment placed in service before February 9, 2018.

(ii) Equipment placed in service on or after February 9, 2018.

(iii) Reporting.

(2) Contractually ensuring disposal, injection, or utilization of qualified carbon oxide.

(i) Binding written contract.

(ii) Multiple binding written contracts permitted.

(iii) Contract provisions.

(iv) Reporting of contract information.

(v) Relationship with election to allow section 45Q credit.

(3) Election to allow the section 45Q credit to another taxpayer.

(i) Example.

(ii) Time and manner of making election.

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(v) Requirements for credit claimant.

(i) Applicability date.

*§1.45Q-2 Definitions for Purposes of §§1.45Q-1 through 1.45Q-5.*

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 (b) Recycled carbon oxide.  
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 (h) Qualified enhanced oil or natural gas recovery project.  
 (1) Application of §§1.43-2 and 1.43-3.  
 (2) Required certification.  
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- §1.45Q-3 Secure Geological Storage.*
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- §1.45Q-4 Utilization of Qualified Carbon Oxide.*
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 (i) Limited exceptions.  
 (j) Applicability date.
- §1.45Q-1 Credit for Carbon Oxide Sequestration.*
- (a) *In general.* For purposes of section 38 of the Internal Revenue Code (Code), the carbon oxide sequestration credit is determined under section 45Q of the Code and this section. Generally, the amount of the section 45Q credit and the party that is eligible to claim the credit depend on whether the taxpayer captures qualified carbon oxide using carbon capture equipment originally placed in service at a qualified facility before February 9, 2018, or on or after February 9, 2018, and whether the taxpayer disposes of the qualified carbon oxide in secure geological storage without using it as a tertiary injectant in a qualified enhanced oil or natural gas recovery project (disposal), uses it as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposes of it in secure geological storage (injection), or utilizes it in a manner described in section 45Q(f)(5) and §1.45Q-4 (utilization). The section 45Q credit applies only with respect to qualified carbon oxide the capture and disposal, injection, or utilization of which is within the United States (within the meaning of section 638(1) of the Code) or a possession of the United States (within the meaning of section 638(2)).
- (b) *Credit amount for carbon capture equipment originally placed in service before February 9, 2018.* For carbon capture equipment originally placed in service at a qualified facility before February 9, 2018, the amount of credit determined under section 45Q(a) and this section is the sum of—
- (1) \$20 per metric ton of qualified carbon oxide that is—
- (i) Captured by the taxpayer at the qualified facility and disposed of by the taxpayer in secure geological storage, and
- (ii) Not used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project or utilized by the taxpayer in a manner described in section 45Q(f)(5) and §1.45Q-4, and
- (2) \$10 per metric ton of qualified carbon oxide that is—
- (i) captured by the taxpayer at the qualified facility and used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, and disposed of by the taxpayer in secure geological storage, or
- (ii) captured by the taxpayer at the qualified facility and utilized by the taxpayer in a manner described in section 45Q(f)(5) and §1.45Q-4.
- (3) Inflation Adjustment. In the case of any taxable year beginning in a calendar year after 2009, there is substituted for each dollar amount contained in paragraphs (b)(1) and (b)(2) of this section an amount equal to the product of—
- (A) Such dollar amount, multiplied by
- (B) The inflation adjustment factor for such calendar year determined under sec-

tion 43(b)(3)(B) for such calendar year, determined by substituting “2008” for “1990.”

(c) *Credit amount for carbon capture equipment originally placed in service on or after February 9, 2018.* For carbon capture equipment originally placed in service at a qualified facility on or after February 9, 2018, the amount of credit determined under sections 45Q(a)(3) and (4) and this section is the sum of—

(1) the applicable dollar amount (as determined under paragraphs (d)(1) and (d)(2) of this section) per metric ton of qualified carbon oxide that is captured during the 12-year period beginning on the date the equipment was originally placed in service, and is —

(i) Disposed of by the taxpayer in secure geological storage, and

(ii) Not used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project or utilized by the taxpayer in a manner described in sections 45Q(f)(5) and §1.45Q-4; and

(2) the applicable dollar amount (as determined under paragraphs (d)(3) and (d)(4) of this section) per metric ton of qualified carbon oxide that is captured during the 12-year period beginning on the date the equipment as originally placed in service and is —

(i) Used by the taxpayer as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and disposed of by the taxpayer in secure geological storage, or

(ii) Utilized by the taxpayer in a manner described in sections 45Q(f)(5) and §1.45Q-4.

(d) *Applicable dollar amount.* In general, the applicable dollar amount depends on whether section 45Q(a)(3) and paragraph (c)(1) of this section applies or section 45Q(a)(4) and paragraph (c)(2) of this section applies, and whether the taxable year begins in a calendar year after 2016 and before 2027.

(1) *Applicable dollar amount for any taxable year beginning in a calendar year after 2016 and before 2027 for qualified carbon oxide not used as a tertiary injectant or utilized.* For purposes of section 45Q(a)(3) and paragraph (c)(1) of this section, the applicable dollar amount for each taxable year beginning in a calendar year after 2016 and before 2027 is:

Year	Applicable Dollar Amount
2017	\$22.66
2018	\$25.70
2019	\$28.74
2020	\$31.77
2021	\$34.81
2022	\$37.85
2023	\$40.89
2024	\$43.92
2025	\$46.96
2026	\$50.00

(2) *Applicable dollar amount for any taxable year beginning in a calendar year after 2026 for qualified carbon oxide not used as a tertiary injectant or utilized.* For purposes of section 45Q(a)(3) and paragraph (c)(1) of this section, the applicable dollar amount for any taxable year beginning in any calendar year after 2026 is an amount equal to the product of \$50 and the inflation adjustment factor for the calendar year determined under section 43(b)(3)(B) for the calendar year, determined by substituting “2025” for “1990.”

(3) *Applicable dollar amount for any taxable year beginning in a calendar year after 2016 and before 2027 for qualified carbon oxide used as a tertiary injectant or utilized.* For purposes of section 45Q(a)(4) and paragraph (c)(2) of this section, the applicable dollar amount for each taxable year beginning in a calendar year after 2016 and before 2027 is:

Year	Applicable Dollar Amount
2017	\$12.83
2018	\$15.29
2019	\$17.76
2020	\$20.22
2021	\$22.68
2022	\$25.15
2023	\$27.61
2024	\$30.07
2025	\$32.54
2026	\$35.00

(4) *Applicable dollar amount for any taxable year beginning in a calendar year after 2026 for qualified carbon oxide used as a tertiary injectant or utilized.* For purposes of section 45Q(a)(4) and paragraph (c)(2) of this section, the applicable dollar amount for any taxable year beginning in any calendar year after 2026 is an amount equal to the product of \$35 and the inflation adjustment factor for such calendar year determined under section 43(b)(3)(B) for such calendar year, determined by substituting “2025” for “1990.”

(e) *Election to apply the \$10 and \$20 credit amounts in lieu of the applicable dollar amounts.* For purposes of determining the carbon oxide sequestration credit under this section, a taxpayer may elect to have the dollar amounts applicable under section 45Q(a)(1) or (2) and paragraph (b) of this section apply in lieu of the dollar amounts applicable under section 45Q(a)(3) or (4) and paragraph (d) of this section for each metric ton of qualified carbon oxide which is captured by the taxpayer using carbon capture equipment which is originally placed in service at a qualified facility on or after February 9, 2018. The election must be made on a Form 8933, *Carbon Oxide Sequestration Credit* (or successor forms, or pursuant to instructions and other guidance), and applies to all metric tons of qualified carbon oxide captured by the taxpayer at the qualified facility throughout the full 12-year credit period.

(f) *Application of section 45Q for certain carbon capture equipment placed in service before February 9, 2018.* In the case of any carbon capture equipment placed in service before February 9, 2018, the credits under section 45Q(a)(1) and (a)(2) and paragraphs (b)(1) and (b)(2) of this section apply with respect to qualified carbon oxide captured using such equipment before the end of the calendar year in which the Secretary, in consultation with the Administrator of the Environmental Protection Agency (EPA), certifies that, during the period beginning after October 3, 2008, a total of 75,000,000 metric tons of qualified carbon oxide have been taken into account in accordance with section 45Q(a), as in effect on February 9, 2018, and section 45Q(a)(1) and (2). In general, a taxpayer may not claim credits under section 45Q(a)(1) and (a)(2) in taxable years after the year in which the 75,000,000 metric ton limit is reached with respect to carbon capture equipment placed in service before February 9, 2018.

However, see §1.45Q-2(g)(4) regarding the election for applicable facilities to treat certain carbon capture equipment as having been placed in service on February 9, 2018.

(g) *Installation of additional carbon capture equipment.* In general, a facility that placed carbon capture equipment in service before February 9, 2018, is entitled to the credit amounts for property placed in service before February 9, 2018, subject to the limitations under paragraph (f) of this section. The same facility may place additional carbon capture equipment in service on or after February 9, 2018. The additional carbon capture equipment is eligible to qualify for the section 45Q credit amounts for equipment placed in service on or after February 9, 2018.

(1) *Allocation of section 45Q credits for facilities installing additional carbon capture equipment.* In the case of a qualified facility placed in service before February 9, 2018, for which additional carbon capture equipment is placed in service on or after February 9, 2018, the amount of qualified carbon oxide which is captured by the taxpayer is equal to—

(i) For purposes of section 45Q(a)(1) (A) and (2)(A), and paragraphs (b)(1) and (b)(2) of this section, the lesser of the total amount of qualified carbon oxide captured at such facility for the taxable year, or the total amount of the carbon dioxide capture capacity of the carbon capture equipment in service at such facility on February 8, 2018, and

(ii) For purposes of section 45Q(a)(3) (A) and (4)(A), and paragraphs (c)(1) and (c)(2) of this section, an amount (not less than zero) equal to the excess of the total amount of qualified carbon oxide captured at such facility for the taxable year, over the total amount of the carbon dioxide capture capacity of the carbon capture equipment in service at such facility on February 8, 2018.

(2) *Additional carbon capture equipment.* A physical modification or equipment addition that results in an increase in the carbon dioxide capture capacity of existing carbon capture equipment constitutes the installation of additional carbon capture equipment. Merely increasing the amount of carbon dioxide captured by existing carbon capture equipment, even if it operated above the carbon dioxide

capture capacity, does not constitute the installation of additional carbon capture equipment.

(3) *New carbon capture equipment.* The cost of a physical modification or equipment addition with a cost that satisfies the 80/20 Rule in §1.45Q-2(g)(5) constitutes the installation of new carbon capture equipment rather than the installation of additional carbon capture equipment.

(4) *Examples.* The following examples illustrate the rules of this paragraph (g):

(i) *Example 1.* Taxpayer X owns qualifying facility QF. In 2017, X placed in service three units of carbon capture equipment – CC1, CC2, and CC3 – to capture carbon dioxide emitted by QF. Each of CC1, CC2, and CC3 are capable of capturing 50,000 metric tons of carbon dioxide. In 2017, X enters into a binding written contract with Y to provide 100,000 metric tons of carbon dioxide annually for Y to dispose of in secure geological storage. X operates CC1 and CC2 to capture carbon dioxide pursuant to the binding written contract with Y, leaving CC3 idle. In 2020, X enters into a binding written contract with Z to provide 50,000 metric tons of carbon dioxide annually for Z to dispose of in secure geological storage. X operates CC3 to capture carbon dioxide pursuant to the binding written contract with Z. CC3 is not additional carbon capture equipment under §1.45Q-1(g)(2). As a result, any section 45Q credits attributable to the carbon dioxide captured by CC3 and disposed of by Z are calculated under section 45Q(a)(1) and §1.45Q-1(b)(1), and are subject to the 75,000,000 metric ton limitation described in section 45Q(g) and §1.45Q-1(f).

(ii) *Example 2.* Assume the same facts as in Example 1, except that in 2019, X makes a physical modification to upgrade CC3 that results in the ability of CC3 to capture 100,000 metric tons of carbon dioxide. The physical modification to upgrade CC3 does not satisfy the 80/20 Rule in §1.45Q-2(g)(5). In 2020 X enters into a binding written contract with Z to provide 100,000 metric tons of carbon dioxide annually for Z to dispose of in secure geological storage. X operates CC3 to capture carbon dioxide pursuant to the binding written contract with Z. Because the carbon dioxide capture capacity of CC3 was 50,000 metric tons of carbon dioxide before the physical modification and 100,000 metric tons of carbon dioxide after the physical modification, the physical modification to upgrade CC3 is considered the installation of additional carbon capture equipment under §1.45Q-1(g)(2). As a result, any section 45Q credits attributable to the first 50,000 metric tons of carbon dioxide captured by CC3 and disposed of by Z are calculated under section 45Q(a)(1) and §1.45Q-1(b)(1), and are subject to the 75,000,000 metric ton limitation described in section 45Q(g) and §1.45Q-1(f). Any section 45Q credits attributable to additional carbon dioxide captured by CC3 and disposed of by Z in excess of those first 50,000 metric tons are calculated under section 45Q(a)(4) and §1.45Q-1(c)(2), and are not subject to the 75,000,000 metric ton limitation described in section 45Q(g) and §1.45Q-1(f).

(iii) *Example 3.* Assume the same facts as in Example 2, except that the physical modification to upgrade CC3 satisfies the 80/20 Rule in §1.45Q-2(g)(5). The physical modification to upgrade CC3 is considered the installation of new carbon capture equipment under §1.45Q-1(g)(2) and §1.45Q-1(g)(3). As a result, any section 45Q credits attributable to carbon dioxide captured by CC3 and disposed of by Z are calculated under section 45Q(a)(4) and §1.45Q-1(c)(2), and are not subject to the 75,000,000 metric ton limitation described in section 45Q(g) and §1.45Q-1(f).

(h) *Eligibility for the section 45Q credit.* The following rules determine who may claim the section 45Q credit.

(1) *Person to whom the section 45Q credit is attributable.* In general, the person to whom the credit is attributable is the person who may claim the credit. Except as provided in §1.45Q-1(h)(3), the section 45Q credit is attributable to the following persons —

(i) *Equipment placed in service before February 9, 2018.* In the case of qualified carbon oxide captured using carbon capture equipment that is originally placed in service at a qualified facility before February 9, 2018, the section 45Q credit is attributable to the person that captures and physically or contractually ensures the disposal, injection, or utilization of such qualified carbon oxide.

(ii) *Equipment placed in service on or after February 9, 2018.* In the case of qualified carbon oxide captured using carbon capture equipment that is originally placed in service at a qualified facility on or after February 9, 2018, the section 45Q credit is attributable to the person that owns the carbon capture equipment and physically or contractually ensures the capture and disposal, injection, or utilization of such qualified carbon oxide.

(iii) *Reporting.* The taxpayer described in §1.45Q-1(h)(1) as eligible to claim the section 45Q credit must claim the credit on a Form 8933 (or successor forms, or pursuant to instructions and other guidance) with the taxpayer's Federal income tax return or Form 1065 for each taxable year for which the taxpayer is eligible. The taxpayer must provide the name and location of the qualified facilities at which the qualified carbon oxide was captured. If the taxpayer is claiming the section 45Q credit on an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, the taxpayer must state AMENDED RETURN FOR SECTION

45Q CREDIT at the top of the amended Federal income tax return, the amended Form 1065, or the AAR, as applicable. In addition, as provided in Revenue Procedure 2020-23, 2020-18 I.R.B. 749 (see §601.601(d)(2)(i)(b) and (ii) of this chapter), the exception applies regarding the time to file an amended return by a BBA partnership for the 2018 and 2019 taxable years. The amended Federal income tax return or the amended Form 1065 must be filed, in no event, later than the applicable period of limitations on assessment for the taxable year for which the amended Federal income tax return or Form 1065 is being filed. In the case of a BBA partnership that chooses not to file an amended Form 1065 as permitted under Revenue Procedure 2020-23, the BBA partnership may make a late election by filing an AAR on or before October 15, 2021, but in no event, later than the applicable period of limitations on making adjustments under section 6235 for the reviewed year, as defined in §301.6241-1(a)(8) of the Procedure and Administration Regulations (26 CFR Part 301).

(2) *Contractually ensuring disposal, injection, or utilization of qualified carbon oxide.* A taxpayer is not required to physically carry out the disposal, injection, or utilization of qualified carbon oxide to claim the section 45Q credit if the taxpayer contractually ensures in a binding written contract that the party that physically carries out the disposal, injection, or utilization of the qualified carbon oxide does so in the manner required under section 45Q and these regulations.

(i) *Binding written contract.* A written contract is binding only if it is enforceable under State law against both the taxpayer and the party that physically carries out the disposal, injection, or utilization of the qualified carbon oxide, or a predecessor or successor of either, and does not limit damages to a specified amount.

(ii) *Multiple binding written contracts permitted.* A taxpayer may enter into multiple binding written contracts with multiple parties for the disposal, injection, or utilization of qualified carbon oxide.

(iii) *Contract provisions.* Contracts ensuring the disposal, injection, or utilization of qualified carbon oxide —

(A) Must include commercially reasonable terms and provide for enforce-

ment of the party's obligation to perform the disposal, injection, or utilization of the qualified carbon oxide;

(B) May, but are not required to, include long-term liability provisions, indemnity provisions, penalties for breach of contract, or liquidated damages provisions;

(C) May, but are not required to, include information including how many metric tons of qualified carbon oxide the parties agree to dispose of, inject, or utilize;

(D) May, but are not required to, include minimum quantities that the parties agree to dispose of, inject, or utilize;

(E) Must, in the case of qualified carbon oxide that is intended to be disposed of in secure geological storage and not used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, obligate the disposing party to comply with §§1.45Q-3(b)(1) and 1.45Q-3(c), and, in the case of a recapture event, promptly inform the capturing party of all information that is pertinent to the recapture (i.e., location of leak, quantity of qualified carbon oxide leaked, dollar value of section 45Q credit attributable to leaked qualified carbon oxide) of section 45Q credits as listed in §1.45Q-5;

(F) Must, for qualified carbon oxide that is intended to be used as a tertiary injectant in a qualified enhanced oil or natural gas recovery, obligate the disposing party to comply with §1.45Q-3(b)(1) or (2) and §1.45Q-3(c), and in the case of a recapture event, promptly inform the capturing party of all information that is pertinent to recapture of the section 45Q credit as listed in §1.45Q-5; and

(G) Must, for qualified carbon oxide that is intended to be utilized in a manner specified in §1.45Q-4, obligate the utilizing party to comply with §1.45Q-4.

(iv) *Reporting of contract information.* The existence of each contract and the parties involved must be reported to the IRS annually on a Form 8933 (or successor forms, or pursuant to instructions and other guidance) by each party to the contract, regardless of the party claiming the credit. In addition to any information stated as required on Form 8933 (or successor forms, or pursuant to instructions and other guidance), the report must include the following information—

(A) The name and taxpayer identification number of the taxpayer to whom the credit is attributable;

(B) The name and taxpayer identification number of each party with whom the taxpayer has entered into a contract to ensure the disposal, injection, or utilization of qualified carbon oxide;

(C) The number of metric tons of qualified carbon oxide each contracting party disposes of, injects, or utilizes on behalf of the contracting taxpayer each taxable year for reporting to the IRS; and

(D) For contracts for the disposal of qualified carbon oxide in secure geological storage or the use of qualified carbon oxide as a tertiary injectant in enhanced oil or natural gas recovery, the name of the operator, the field, unit, and reservoir, location by county and state, and identification number assigned to the facility by the EPA's electronic Greenhouse Gas Reporting Tool (e-GGRT ID number) for submission of the facility's 40 CFR Part 98 annual reports.

(v) *Relationship with election to allow section 45Q credit.* A taxpayer does not elect to allow all or a portion of the credit to any of the contracting parties merely by contracting with that party to ensure the disposal, injection, or utilization of qualified carbon oxide. Any election to allow all or a portion of the credit to be claimed by another party must be made separately pursuant to §1.45Q-1(h)(3).

(3) *Election to allow the section 45Q credit to another taxpayer.* The taxpayer described in §1.45Q-1(h)(1) as eligible to claim section 45Q credits may elect to allow the person that disposes of the qualified carbon oxide, utilizes the qualified carbon oxide, or uses the qualified carbon oxide as a tertiary injectant to claim the credit (credit claimant). The taxpayer that makes the election (electing taxpayer) may not claim any section 45Q credits that are allowable to a credit claimant. An electing taxpayer may elect to allow a credit claimant to claim the full amount or a partial amount of section 45Q credits arising during the taxable year. An electing taxpayer may elect to allow a single credit claimant or multiple credit claimants to claim section 45Q credits in the same taxable year. If an electing taxpayer elects to allow multiple credit claimants to claim section 45Q credits, the maximum

amount of section 45Q credits allowable to each credit claimant is proportional to the amount of qualified carbon oxide disposed of, utilized, or used as a tertiary injectant by the credit claimant. A credit claimant may receive allowances of section 45Q credits from multiple electing taxpayers in the same taxable year.

(i) *Example.* Electing Taxpayer, E, captures 100 metric tons of qualified carbon oxide with carbon capture equipment that was placed in service in 2017. E contracts with two companies, A and B, for the disposal of the qualified carbon oxide. The capture and disposal of the qualified carbon oxide makes E eligible for a section 45Q credit at a rate of \$10 per metric ton, for a total section 45Q credit of \$1,000. E contractually ensures that A will dispose of 30 metric tons of qualified carbon oxide and that B will dispose of 70 metric tons of qualified carbon oxide. E may make a section 45Q(f)(3)(B) election to allow up to \$300 of section 45Q credit to A and up to \$700 of section 45Q credit to B, equal to the value of the number of metric tons each party has contracted to ensure disposal, multiplied by the credit value of the metric tons disposed of.

(ii) *Time and manner of making election.* The taxpayer described §1.45Q-1(h)(1) makes a section 45Q(f)(3)(B) election by filing a statement of election containing the information described in §1.45Q-1(h)(3)(iv) with the taxpayer's Federal income tax return or Form 1065 for each taxable year in which the credit arises. The section 45Q(f)(3)(B) election must be made in accordance with Form 8933 (or successor forms, or pursuant to instructions and other guidance) no later than the time prescribed by law (including extensions) for filing the Federal income tax return or Form 1065 for the year in which the credit arises. The election may not be filed with an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, after the prescribed date (including extensions) for filing the original Federal income tax return or Form 1065 for the year, with the exception of amended Federal income tax returns, amended Forms 1065, or AARs, as applicable, for any taxable year ending after February 9, 2018, but not for taxable years beginning after the date of issuance of this proposed regulation. In addition, as provided in Revenue Procedure 2020-23, the exception applies regarding the time to file an amended return by a partnership subject to the centralized partnership audit regime enacted as part of the BBA (BBA partnership) for the 2018 and 2019 taxable years. The amended Federal income tax

return or the amended Form 1065 must be filed, in no event, later than the applicable period of limitations on assessment for the taxable year for which the amended Federal income tax return or Form 1065 is being filed. In the case of a BBA partnership that chooses not to file an amended Form 1065 as permitted under Revenue Procedure 2020-23, the BBA partnership may make a late election by filing an AAR on or before October 15, 2021, but in no event, later than the applicable period of limitations on making adjustments under section 6235 for the reviewed year, as defined in §301.6241-1(a)(8) of the Procedure and Administration Regulations (26 CFR Part 301).

(iii) *Annual election.* A new section 45Q(f)(3)(B) election must be made annually.

(iv) *Required information.* For the election to be valid, the election statement of the electing taxpayer on Form 8933 (or successor forms, or pursuant to instructions and other guidance) under §1.45Q-1(h)(3)(ii) must indicate that an election is being made under section 45Q(f)(3)(B). The electing taxpayer must provide each credit claimant with a copy of the electing taxpayer's Form 8933 (or successor forms, or pursuant to instructions and other guidance). The electing taxpayer must, in addition to any information required on Form 8933 (or successor forms, or pursuant to instructions and other guidance), set forth the following information—

(A) The electing taxpayer's name, address, taxpayer identification number, location, and e-GGRT ID number(s) (if available) of each qualified facility where carbon oxide was captured;

(B) The full amount of credit attributable to the taxpayer prior to the election;

(C) The name, address, and taxpayer identification number of each credit claimant, and the location and e-GGRT ID number(s) (if available) of each secure geological storage facility where the qualified carbon oxide is disposed of or injected;

(D) The dollar amount of section 45Q credits the taxpayer is allowing each credit claimant to claim and the corresponding metric tons of qualified carbon oxide; and

(E) The dollar amount of section 45Q credits retained by the electing taxpayer

and the corresponding metric tons of qualified carbon oxide.

(v) *Requirements for section 45Q credit claimant.* For a section 45Q(f)(3)(B) election to be valid, the section 45Q credit claimant must include the following information on Form 8933 (or successor forms, or pursuant to instructions and other guidance) with its timely filed Federal income tax return or Form 1065 (including extensions)—

(A) The name, address, taxpayer identification number of the credit claimant;

(B) The name, address, and taxpayer identification number of each taxpayer making an election under section 45Q(f)(3)(B) to allow the credit to the credit claimant;

(C) The location and e-GGRT ID number(s) (if available) of each qualified facility where carbon oxide was captured;

(D) The location and e-GGRT ID number(s) (if available) of each secure geological storage facility where the qualified carbon oxide is disposed of or injected;

(E) The full dollar amount of section 45Q credits attributable to each electing taxpayer prior to the election and the corresponding metric tons of carbon oxide;

(F) The dollar amount of section 45Q credits that each electing taxpayer is allowing the credit claimant to claim and the corresponding metric tons of carbon oxide; and

(G) A copy of the electing taxpayer's Form 8933 (or successor forms, or pursuant to instructions and other guidance).

(i) *Applicability date.* This section applies to taxable years beginning after [INSERT DATE FINAL REGULATIONS ARE PUBLISHED IN THE Federal Register]. Taxpayers may choose to apply this section for taxable years beginning on or after February 9, 2018, provided the taxpayer applies this section and §§1.45Q-2, 1.45Q-3, 1.45Q-4, and 1.45Q-5 in their entirety and in a consistent manner.

#### *§1.45Q-2 Definitions for Purposes of §§1.45Q-1 through 1.45Q-5.*

(a) *Qualified carbon oxide.* The term qualified carbon oxide means—

(1) Any carbon dioxide which—

(i) Is captured from an industrial source by carbon capture equipment which is

originally placed in service before February 9, 2018,

(ii) Would otherwise be released into the atmosphere as industrial emission of greenhouse gas or lead to such release, and

(iii) Is measured at the source of capture and verified at the point of disposal, injection, or utilization; or

(2) Any carbon dioxide or other carbon oxide which—

(i) Is captured from an industrial source by carbon capture equipment which is originally placed in service on or after February 9, 2018,

(ii) Would otherwise be released into the atmosphere as industrial emission of greenhouse gas or lead to such release, and

(iii) Is measured at the source of capture and verified at the point of disposal, injection, or utilization; or

(3) In the case of a direct air capture facility, any carbon dioxide that is captured directly from the ambient air and is measured at the source of capture and verified at the point of disposal, injection, or utilization.

(b) *Recycled carbon oxide.* The term qualified carbon oxide includes the initial deposit of captured carbon oxide used as a tertiary injectant. Qualified carbon oxide does not include carbon oxide that is re-captured, recycled, and re-injected as part of the enhanced oil or natural gas recovery process.

(c) *Carbon capture equipment.* In general, carbon capture equipment includes all components of property that are used to capture or process carbon oxide until the carbon oxide is transported for disposal, injection, or utilization.

(1) *Use of carbon capture equipment.* Carbon capture equipment is equipment used for the purpose of—

(i) Separating, purifying, drying, and/or capturing carbon oxide that would otherwise be released into the atmosphere from an industrial facility;

(ii) Removing carbon oxide from the atmosphere via direct air capture; or

(iii) Compressing or otherwise increasing the pressure of carbon oxide.

(2) *Carbon capture equipment components.* Carbon capture equipment generally includes components of property necessary to compress, treat, process, liquefy,

pump or perform some other physical action to capture qualified carbon oxide. Components of carbon capture equipment include, but are not limited to, absorbers, compressors, conditioners, cooling towers, dehydration equipment, dehydration systems, electrostatic filtration, engines, filters, fixtures, glycol contractors, heat exchangers, liquefaction equipment, lube oil systems, machinery, materials, membranes, meters, monitoring equipment, motors, mounting equipment, pipes, power generators and regenerators, pressure vessels and other vessels, processing equipment, processing plants, processing units, pumps, reboilers, recycling units, scrubbers, separation vessels, solvent pumps, sorbent vessels, specially designed flue gas ducts, support structures, tracking equipment, treating equipment, turbines, water wash equipment, and other carbon oxide related equipment.

(3) *Excluded components.* Components of carbon capture equipment do not include pipelines, branch lines, or land and marine transport vessels used for transporting captured qualified carbon oxide for disposal, injection, or utilization. However, a gathering and distribution system that collects carbon oxide captured from a qualified facility or multiple facilities that constitute a single project (as described in section 8.01 of Notice 2020-12, 2020-11 I.R.B. 495 (see §601.601(d)(2)(ii) of this chapter)) for the purpose of transporting that carbon oxide away from the qualified facility or single project to a pipeline used to transport carbon oxide from multiple taxpayers or projects is carbon capture equipment.

(d) *Industrial facility.* An *industrial facility* is a facility that produces a carbon oxide stream from a fuel combustion source or fuel cell, a manufacturing process, or a fugitive carbon oxide emission source that, absent capture and disposal, would otherwise be released into the atmosphere as industrial emission of greenhouse gas or lead to such release.

(1) *Exclusion.* An industrial facility does not include a facility that produces carbon dioxide from carbon dioxide production wells at natural carbon dioxide-bearing formations or a naturally occurring subsurface spring. A deposit of natural gas that contains less than 10 percent carbon dioxide by volume is not

a natural carbon dioxide-bearing formation. For other deposits, whether a well is producing from a natural carbon dioxide-bearing formation is based on all the facts and circumstances.

(2) *Industrial source.* An *industrial source* is an emission of carbon oxide from an industrial facility.

(3) *Manufacturing process.* A *manufacturing process* is a process involving the manufacture of products, other than carbon oxide, that are intended to be sold at a profit, or are used for a commercial purpose. All facts and circumstances with respect to the process and products are to be taken into account.

(4) *Example.* The following example illustrates the rules of paragraph (a) and (d)(3) of this section:

(i) A natural underground reservoir contains a gas that is comprised of 50 percent carbon dioxide and 50 percent methane by volume. The raw gas is not usable without the application of a separation process to create two gases that are primarily carbon dioxide and methane. Taxpayer B constructs processing equipment that separates the raw gas into qualified carbon dioxide and methane. The carbon dioxide is sold to a third party for use in a qualified enhanced oil recovery project. Some of the methane is used as fuel to power the processing equipment. The remainder of the methane is injected into the reservoir. The injection will increase the ultimate recovery of carbon dioxide. The injected methane can be produced later from the reservoir. At the end of the taxable year the taxpayer has not secured a contract to sell methane and does not have any plans to use the methane for a commercial purpose. Because carbon dioxide is the only product manufactured that is intended to be sold at a profit or used for a commercial purpose, the separation process applied to the gases is not a manufacturing process within the meaning of paragraph (d)(3). The carbon dioxide captured by the process is not qualified carbon oxide.

(e) *Electricity generating facility.* An *electricity generating facility* is a facility described in section 45Q(d)(2)(A) or (B) of the Internal Revenue Code (Code) and is subject to depreciation under MACRS Asset Class 49.11(Electric Utility Hydraulic Production Plant), 49.12 (Electric Utility Nuclear Production Plant), 49.13

(Electric Utility Steam Production Plant), or 49.15 (Electric Utility Combustion Turbine Production Plant).

(f) *Direct air capture facility.* A *direct air capture facility* means any facility that uses carbon capture equipment to capture carbon oxide directly from the ambient air. It does not include any facility that captures carbon dioxide (1) that is deliberately released from naturally occurring subsurface springs or (2) using natural photosynthesis.

(g) *Qualified facility.* A *qualified facility* means any industrial facility, electricity generating facility, or direct air capture facility, the construction of which begins before January 1, 2024, and either at which construction of carbon capture equipment begins before that date, or the original planning and design for which includes installation of carbon capture equipment, and at which carbon capture equipment is placed in service that captures the requisite annual thresholds of carbon oxide described in paragraph (g)(1) of this section. See Notice 2020-12, 2020-11 I.R.B. 495 (see §601.601(d)(2)(ii) of this chapter), for guidance on the determination of when construction has begun on a qualified facility or on carbon capture equipment.

(1) *Emissions and capture requirements.* The facility must capture—

(i) In the case of a facility, other than a direct air capture facility, which emits not more than 500,000 metric tons of carbon oxide into the atmosphere during the taxable year, at least 25,000 metric tons of qualified carbon oxide during the taxable year which is utilized in a manner consistent with section 45Q(f)(5) and §1.45Q-4 (Section 45Q(d)(2)(A) Facility);

(ii) In the case of an electricity generating facility which is not a Section 45Q(d)(2)(A) Facility (Section 45Q(d)(2)(B) Facility), not less than 500,000 metric tons of qualified carbon during the taxable year; and

(iii) In the case of a direct air capture facility or other facility that is not a Section 45Q(d)(2)(A) Facility or a Section 45Q(d)(2)(B) Facility, at least 100,000 metric tons of qualified carbon oxide during the taxable year.

(2) *Examples.* The following examples illustrate the rules of paragraph (g) of this section:

(i) *Example 1.* During the taxable year, an ethanol plant emits 200,000 metric tons of carbon dioxide. Equipment located at the facility captures 35,000 metric tons of carbon dioxide, all of which are utilized in a manner consistent with section 45Q(f)(5) and §1.45Q-4. The ethanol plant is a qualified facility during the taxable year because it met the requirement to capture at least 25,000 metric tons of qualified carbon oxide during the taxable year which were utilized in a manner consistent with section 45Q(f)(5) and §1.45Q-4.

(ii) *Example 2.* During the taxable year an electricity generating facility emits 600,000 metric tons of carbon dioxide. Equipment located at the facility captures 50,000 metric tons of carbon dioxide, all of which are utilized in a manner consistent with section 45Q(f)(5) and §1.45Q-4, and 400,000 metric tons of carbon dioxide, all of which are properly disposed of in secure geological storage. The total amount of carbon dioxide captured during the taxable year is 450,000 metric tons. The electricity generating facility is not a qualified facility during the taxable year because it did not meet the requirement to capture not less than 500,000 metric tons of qualified carbon during the taxable year.

(iii) *Example 3.* During the taxable year, a cement manufacturing plant emits 110,000 metric tons of carbon dioxide. Equipment located at the plant captures 10,000 metric tons of carbon dioxide, all of which are utilized in a manner consistent with section 45Q(f)(5) and §1.45Q-4, and 90,000 metric tons of carbon dioxide, all of which are properly disposed of in secure geological storage. The total amount of carbon dioxide captured during the taxable year is 100,000 metric tons. The cement manufacturing plant is a qualified facility during the taxable year because it met the requirement to capture at least 100,000 metric tons of qualified carbon oxide during the taxable year.

(3) *Annualization of first-year qualified carbon oxide emission and capture amounts—*(i) In general. For the year in which carbon capture equipment is placed in service at a qualified facility, annualization of the amount of qualified carbon oxide emitted and captured is permitted to determine if the threshold requirements under paragraph (g)(1) of this section are satisfied. Such annualization may result in a facility being deemed to satisfy the threshold requirements under paragraph (g)(1) of this section for the year and may permit a taxpayer to claim section 45Q credits even though the amount of qualified carbon oxide emitted or captured in its first year is less than the threshold requirements under paragraph (g)(1) of this section.

(ii) *Calculation.* Annualization is only be available for the first year in which the carbon capture equipment is placed in service at the qualified facility. Annualized amounts must be calculated by—

(A) Determining the amount of qualified carbon oxide emitted and captured during the taxable year in which the carbon capture equipment was placed in service at the qualified facility,

(B) Dividing the amount of qualified carbon emitted or captured by the number of days in the tax year beginning with the date on which the carbon capture equipment was placed in service at the qualified facility and ending with the last day of the taxable year; and

(C) Multiplying by 365.

(iii) *Consequences.* If the annualized amounts of qualified carbon oxide emitted and captured as calculated under this formula meet the threshold requirements under paragraph (g)(1) of this section, the threshold requirements under paragraph (g)(1) of this section are deemed satisfied for the taxable year in which the carbon capture equipment was placed in service at the qualified facility. The taxpayer may be eligible for a section 45Q credit for that taxable year but must calculate the credit based on actual amounts of qualified carbon oxide captured and disposed of, injected, or utilized during the taxable year.

(4) *Election for applicable facilities.*

In the case of an applicable facility, for any taxable year during which such facility captures not less than 500,000 metric tons of qualified carbon oxide, the person described in section 45Q(f)(3)(A)(ii) and §1.45Q-1(h)(1), may elect to have such facility, and any carbon capture equipment placed in service at such facility, deemed as having been placed in service on February 9, 2018 (section 45Q(f)(6) election).

(i) *Applicable facility.* An applicable facility means a qualified facility described in section 45Q(f)(6) and §1.45Q-2(g)(4)(i) that was placed in service before February 9, 2018, for which no taxpayer claimed a section 45Q credit for qualified carbon oxide captured at the facility for any taxable year ending before February 9, 2018.

(ii) *Time and manner of making election.* The taxpayer described §1.45Q-1(h)(1) makes a section 45Q(f)(6) election by filing a statement of election with the taxpayer's income tax return for each taxable year in which the credit arises. The section 45Q(f)(6) election must be made in accordance with Form 8933 (or successor forms, or pursuant to instructions and other guidance) with the taxpayer's income

tax return for the taxable year in which the taxpayer makes the section 45Q(f)(6) election. The statement of election must, in addition to any information required on Form 8933 (or successor forms, or pursuant to instructions and other guidance), set forth the electing taxpayer's name, address, taxpayer identification number, location, and e-GGRT ID number(s) (if available) of the applicable facility.

(iii) *Retroactive credit revocations.* A taxpayer may not file an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, for any taxable year ending before February 9, 2018, to revoke a prior claim of section 45Q credits.

(5) *Retrofitted qualified facility or carbon capture equipment (80/20 Rule).* A qualified facility or carbon capture equipment may qualify as originally placed in service even if it contains some used components of property, provided the fair market value of the used components of property is not more than 20 percent of the qualified facility or carbon capture equipment's total value (the cost of the new components of property plus the value of the used components of property) (80/20 Rule). For purposes of the 80/20 Rule, the cost of a new qualified facility or carbon capture equipment includes all properly capitalized costs of the new qualified facility or carbon capture equipment. Solely for purposes of the 80/20 Rule, properly capitalized costs of a new qualified facility or carbon capture equipment may, at the option of the taxpayer, include the cost of new equipment for a pipeline owned and used exclusively by that taxpayer to transport carbon oxides captured from that taxpayer's qualified facility that would otherwise be emitted into the atmosphere.

(h) *Qualified enhanced oil or natural gas recovery project.* The term *qualified enhanced oil or natural gas recovery project* has the same meaning as qualified enhanced oil recovery project under section 43(c)(2) of the Code and §1.43-2, by substituting crude oil or natural gas for crude oil in section 43(c)(2)(A)(i) and §§1.43-2 and 1.43-3.

(1) *Application of §§1.43-2 and 1.43-3.* For purposes of applying §§1.43-2 and 1.43-3 with respect to a qualified enhanced oil or natural gas recovery project, the term enhanced oil or natural gas

recovery is substituted for enhanced oil recovery, and the term oil or natural gas is substituted for oil.

(2) *Required certification.* The qualified enhanced oil or natural gas recovery project must be certified under §1.43-3. For purposes of a natural gas project—

(i) The petroleum engineer's certification under §1.43-3(a)(3) and the operator's continued certification of a project under §1.43-3(b)(3) must include an additional statement that the certification is for purposes of the section 45Q carbon oxide sequestration tax credit;

(ii) The petroleum engineer's certification must be attached to a Form 8933 (or successor forms, or pursuant to instructions and other guidance) and filed not later than the last date prescribed by law (including extensions) for filing the operator's or designated owner's Federal income tax return or Form 1065 for the first taxable year in which qualified carbon oxide is injected into the reservoir; and

(iii) The operator's continued certification of a project must be attached to a Form 8933 (or successor forms, or pursuant to instructions and other guidance) and filed not later than the last date prescribed by law (including extensions) for filing the operator's or designated owner's Federal income tax return or Form 1065 for taxable years after the taxable year for which the petroleum engineer's certification is filed but not after the taxable year in which injection activity ceases and all injection wells are plugged and abandoned.

(3) *Natural gas.* Natural gas has the same meaning as under section 613A(e)(2) of the Code.

(4) *Timely filing of petroleum engineer's certification.* For purposes of this paragraph (h), if a section 45Q credit is claimed on an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, the petroleum engineer's certification will be treated as filed timely if it is attached to a Form 8933 that is submitted with such amended Federal income tax return, amended Form 1065, or AAR. With respect to a section 45Q credit that is claimed on a timely filed Federal income tax return or Form 1065 for a taxable year ending after February 9, 2018 and beginning before the date of issuance of this proposed regulation, for which the petroleum engineer's certifi-

cation was not submitted the petroleum engineer's certification will be treated as filed timely if it is attached to an amended Form 8933 for any taxable year ending after February 9, 2018, but not for taxable years beginning after the date of issuance of these proposed regulations.

(5) *Carbon oxide injected in oil reservoir.* Carbon oxide that is injected into an oil reservoir that is not a qualified enhanced oil recovery project under section 43(c)(2) due to circumstances such as the first injection of a tertiary injectant occurring before 1991, or because a petroleum engineer's certification was not timely filed, cannot be treated as qualified carbon oxide, disposed of in secure geological storage, or utilized in a manner described in section 45Q(f)(5). This rule will not apply to an oil reservoir if—

- (i) The reservoir permanently ceased oil production;
- (ii) The operator has obtained an EPA UIC class VI permit; and
- (iii) The operator complies with 40 CFR Part 98 subpart RR.

(6) *Tertiary Injectant.* For purposes of section 45Q, a tertiary injectant is qualified carbon oxide that is injected into and stored in a qualified enhanced oil or natural gas recovery project and contributes to the extraction of crude oil or natural gas. The term *tertiary injectant* has the same meaning as used within section 193(b)(1) of the Code.

(i) *Section 45Q credit.* The term *section 45Q credit* means the carbon oxide sequestration credit determined under section 45Q of the Internal Revenue Code and §1.45Q-1.

(j) *Applicability date.* This section applies to taxable years beginning after [INSERT DATE FINAL REGULATIONS ARE PUBLISHED IN THE Federal Register.] Taxpayers may choose to apply this section for taxable years beginning on or after February 9, 2018, provided the taxpayer applies this section and §§1.45Q-1, 1.45Q-3, 1.45Q-4, and 1.45Q-5 in their entirety and in a consistent manner.

#### *§1.45Q-3 Secure Geological Storage.*

(a) *In general.* To qualify for the section 45Q credit, a taxpayer must either physically or contractually dispose of captured qualified carbon oxide in secure

geological storage in the manner provided in §1.45Q-3(b) or utilize qualified carbon oxide in a manner conforming with section 45Q(f)(5) of the Internal Revenue Code and §1.45Q-4. Secure geological storage includes, but is not limited to, storage at deep saline formations, oil and gas reservoirs, and unminable coal seams.

(b) *Requirements for secure geological storage.* For purposes of the section 45Q credit, qualified carbon oxide is considered disposed of by the taxpayer in secure geological storage such that the qualified carbon oxide does not escape into the atmosphere if the qualified carbon oxide is—

(1) Stored, and not used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project, in compliance with applicable requirements under 40 CFR Part 98 subpart RR; or

(2) Used as a tertiary injectant in a qualified enhanced oil or natural gas recovery project and stored in compliance with applicable requirements under 40 CFR Part 98 subpart RR, or the International Organization for Standardization (ISO) standards endorsed by the American National Standards Institute (ANSI) under CSA/ANSI ISO 27916:19, Carbon dioxide capture, transportation and geological storage – Carbon dioxide storage using enhanced oil recovery (CO<sub>2</sub>-EOR).

(3) Injected into a well that complies with applicable Underground Injection Control regulations onshore or offshore under submerged lands within the territorial jurisdiction of States.

(c) *Documentation.* Documentation must be filed in accordance with Form 8933 (or successor forms, or pursuant to instructions and other guidance).

(d) *Certification.* For qualified enhanced oil or natural gas recovery projects in which the taxpayer reported volumes of carbon oxide to the EPA pursuant to 40 CFR Part 98 subpart RR, the taxpayer may self-certify the volume of carbon oxide claimed for purposes of section 45Q. For qualified enhanced oil or natural gas recovery projects in which the taxpayer determined volumes pursuant to CSA/ANSI ISO 27916:19, a taxpayer may prepare documentation as outlined in CSA/ANSI 27916:19 internally, but such documentation must be provided to a qualified independent engineer or geologist, who

then must certify that the documentation provided, including the mass balance calculations as well as information regarding monitoring and containment assurance, is accurate and complete. Certifications must be made annually. For any leaked amount of qualified carbon oxide (as defined in §1.45Q-5(c)) that is determined pursuant to CSA/ANSI ISO 27916:19, the certification must also include a statement that the quantity was determined in accordance with sound engineering principles. Taxpayers that capture qualified carbon oxide giving rise to the section 45Q credit must file Form 8933 (or successor forms, or pursuant to instructions and other guidance) with a timely filed Federal income tax return or Form 1065, including extensions or for the purpose of this rule, amendments to Federal income tax returns, Forms 1065, or on AARs, as applicable. Taxpayers that dispose of, inject, or utilize qualified carbon oxide must also file Form 8933 (or successor forms, or pursuant to instructions and other guidance) with a timely filed Federal income tax return or Form 1065, including extensions or for the purpose of this rule, amendments to Federal income tax returns, Forms 1065, or on AARs, as applicable. If the volume of carbon oxide certified and reported is a negative amount, see §1.45Q-5 for rules regarding recapture.

(e) *Failure to submit complete documentation or certification.* No section 45Q credit is allowed for any taxable year for which the taxpayer (including credit claimants) has failed to timely submit complete documentation and certification that is required by this regulation or Form 8933 (or successor forms, or pursuant to instructions and other guidance). The credit will be allowed only for a taxable year for which complete documentation and certification has been timely submitted. Certifications for each taxable year must be submitted by the due date of the federal income tax return or Form 1065 on which the section 45Q credit is claimed, including extensions. If a section 45Q credit is claimed on an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, certifications may also be submitted with such amended Federal income tax return, amended Form 1065, or AAR. If a section 45Q credit was claimed on a timely filed

Federal income tax return or Form 1065 for a taxable year ending after February 9, 2018, and beginning before the date of issuance of this proposed regulation, for which certifications were not submitted, such certifications may be submitted with an amended Federal income tax return, an amended Form 1065, or an AAR, as applicable, for the taxable year in which the section 45Q credit was claimed.

(f) *Applicability date.* This section applies to taxable years beginning after [INSERT DATE FINAL REGULATIONS ARE PUBLISHED IN THE Federal Register.] Taxpayers may choose to apply this section for taxable years beginning on or after February 9, 2018, provided the taxpayer applies this section and §§1.45Q-1, 1.45Q-2, 1.45Q-4, and 1.45Q-5 in their entirety and in a consistent manner.

#### *§1.45Q-4 Utilization of Qualified Carbon Oxide.*

(a) *In general.* For purposes of this section, utilization of qualified carbon oxide means—

(1) The fixation of qualified carbon oxide through photosynthesis or chemosynthesis, such as through the growing of algae or bacteria,

(2) The chemical conversion of such qualified carbon oxide to a material or chemical compound in which such qualified carbon oxide is securely stored, or

(3) The use of such qualified carbon oxide for any other purpose for which a commercial market exists (with the exception of use as a tertiary injectant in a qualified enhanced oil or natural gas recovery project), as determined by the Secretary of the Treasury or his delegate.

(b) *Measurement.* For purposes of determining the amount of qualified carbon oxide utilized by the taxpayer under §1.45Q-1(b)(2)(ii) and (c)(2)(ii), such amount is equal to the metric tons of qualified carbon oxide which the taxpayer demonstrates, based upon an analysis of lifecycle greenhouse gas emissions (LCA), were—

(1) Captured and permanently isolated from the atmosphere (isolated), or

(2) Displaced from being emitted into the atmosphere through use of a process described in paragraph (a) of this section (displaced).

(c) *Lifecycle greenhouse gas emissions and lifecycle analysis*—(1) In general. For purposes of paragraph (b) of this section, the term lifecycle greenhouse gas emissions means the aggregate quantity of greenhouse gas emissions (including direct emissions and significant indirect emissions such as significant emissions from land use changes) related to the full product lifecycle, including all stages of product and feedstock production and distribution, from feedstock generation or extraction through the distribution and delivery and use of the finished product to the ultimate consumer, where the mass values for all greenhouse gases are adjusted to account for their relative global warming potential according to Table A-1 of 40 CFR Part 98 subpart A.

(2) *Measurement*. The taxpayer measures the amount of carbon oxide captured and utilized through a combination of direct measurement and LCA. The measurement and written LCA report must be performed by or verified by an independent third-party. The report must contain documentation consistent with the International Organization for Standardization (ISO) 14044:2006, “Environmental management — Life cycle assessment — Requirements and Guidelines,” as well as a statement documenting the qualifications of the third-party, including proof of appropriate U.S. or foreign professional license, and an affidavit from the third-party stating that it is independent from the taxpayer.

(3) *Approval of the LCA*. The taxpayer must submit the written LCA report required by paragraph (c)(1) of this section to the IRS and the Department of Energy (DOE). The LCA will be subject to a technical review by the DOE, and the IRS, in consultation with the DOE and the Environmental Protection Agency, will determine whether to approve the LCA.

(4) *Submission of the LCA*. [Reserved].

(d) *Commercial market*. [Reserved].

(e) *Standards of adequate lifecycle analysis*. [Reserved].

(f) *Applicability date*. This section applies to taxable years beginning after [INSERT DATE FINAL REGULATIONS ARE PUBLISHED IN THE Federal Register.] Taxpayers may choose to apply this section for taxable years beginning on or after February 9, 2018, provided the

taxpayer applies this section and §§1.45Q-1, 1.45Q-2, 1.45Q-3, and 1.45Q-5 in their entirety and in a consistent manner.

#### *§1.45Q-5 Recapture of Credit.*

(a) *Recapture event*. A recapture event occurs when qualified carbon oxide for which a section 45Q credit has been claimed ceases to be captured, disposed of, or used as a tertiary injectant during the recapture period. Recapture events are determined separately for each project involving capture, disposal, or use of qualified carbon oxide as a tertiary injectant.

(b) *Causes to be captured, disposed of, or used as a tertiary injectant*. Qualified carbon oxide ceases to be captured, disposed of, or used as a tertiary injectant if the leaked amount of qualified carbon oxide in the taxable year exceeds the amount of qualified carbon oxide disposed of in secure geological storage or used as a tertiary injectant in that same taxable year.

(c) *Leaked amount of qualified carbon oxide*. When a taxpayer, operator, or regulatory agency determines that qualified carbon oxide has leaked to the atmosphere, the taxpayer must quantify the metric tons of qualified carbon oxide that has leaked to the atmosphere pursuant to the requirements of 40 CFR Part 98 subpart RR or CSA/ANSI ISO 27916:19. The quantity determined pursuant to CSA/ANSI ISO 27916:19 must be certified by a qualified independent engineer or geologist, including a statement that the quantity was determined in accordance with sound engineering principles. The Internal Revenue Service will consider all available facts, and may consult with the relevant regulatory agency, in verifying the amount of qualified carbon oxide that has leaked to the atmosphere. That amount is the leaked amount of qualified carbon oxide.

(d) *Recaptured qualified carbon oxide*. The quantity of recaptured qualified carbon oxide (in metric tons) is the amount by which the leaked amount of qualified carbon oxide exceeds the amount of qualified carbon oxide disposed of in secure geological storage or used as a tertiary injectant in the taxable year.

(e) *Recapture amount*. The recapture amount is equal to the product of the

quantity of recaptured qualified carbon oxide (in metric tons) and the appropriate statutory credit rate.

(f) *Recapture period*. The recapture period begins on the date of first injection of qualified carbon oxide for disposal in secure geological storage or use as a tertiary injectant. The recapture period ends on the earlier of five years after the last taxable year in which the taxpayer claimed a section 45Q credit or the date monitoring ends under the requirements of the standards described in §1.45Q-3(b)(1) or (b)(2).

(g) *Application of recapture*.

(1) *In general*. Any recapture amount must be taken into account in the taxable year in which it is identified and reported. If the leaked amount of qualified carbon oxide does not exceed the amount of qualified carbon oxide disposed of in secure geological storage or used as a tertiary injectant in the taxable year reported, there is no recapture amount and no further adjustments to prior taxable years are needed. The taxpayer must add the recapture amount to the amount of tax due in the taxable year in which the recapture event occurs.

(2) *Calculation*. Recapture amounts are to be calculated on a last-in-first-out basis (LIFO), such that the leaked amount of qualified carbon oxide that exceeds the amount of qualified carbon oxide disposed of in secure geological storage or used as a tertiary injectant in the current taxable year will be deemed attributable first to the prior taxable year, then to taxable year before that, and then up to a maximum of the fifth preceding year.

(3) *Multiple Units*. In the event of a recapture event in which the leaked qualified carbon oxide had been captured from multiple units of carbon capture equipment that were not under common ownership, the recapture amount must be allocated on a pro rata basis among the multiple units of carbon capture equipment. Each taxpayer that claimed a section 45Q credit with respect to one or more of such units of carbon capture equipment is responsible for adding the recapture amount to their amount of tax due in the taxable year in which the recapture event occurs.

(4) *Multiple Taxpayers*. In the event of a recapture event where the leaked amount

of qualified carbon oxide is deemed attributable to qualified carbon oxide with respect to which multiple taxpayers claimed section 45Q credit amounts (for example, if ownership of the carbon capture equipment was transferred, or if a taxpayer made an election under section 45Q(f)(3) (B) of the Internal Revenue Code to allow one or more credit claimants to claim a portion of the section 45Q credit), the recapture amount must be allocated on a pro rata basis among the taxpayers that claimed the section 45Q credits with respect to the qualified carbon oxide that the leaked qualified carbon oxide is deemed attributable to.

(5) *Reporting.* If a recapture event occurs during a project's recapture period, any taxpayer that claimed a section 45Q credit for that project must report the following information on a Form 8933 (or successor forms, or pursuant to instructions and other guidance) filed with that taxpayer's Federal income tax return or Form 1065 for the taxable year for which the recapture event occurred—

(A) The recapture amount (as defined in §1.45Q-5(e));

(B) The quantity of leaked qualified carbon oxide (in metric tons) (as defined in §1.45Q-5(c));

(C) The statutory credit rate at which the section 45Q credits were originally calculated; and

(D) A statement that describes how the taxpayer became aware of the recapture event, how the leaked amount was determined, and the identity and involvement of any regulatory agencies.

(6) *Examples.* The following examples illustrate the principles of this paragraph (g):

(i) *Example 1.* (A) A owns direct air capture Facility X. No other taxpayer has owned Facility X, and A has never allowed another taxpayer to claim any section 45Q credits with respect to qualified carbon oxide captured by Facility X. Facility X captured 100,000 metric tons of carbon dioxide in each of 2021, 2022, and 2023. All captured carbon dioxide was sold to B for use as a tertiary injectant in a qualified enhanced oil recovery project. B provided contractual assurance that the carbon dioxide would be sequestered in secure geological storage. A claimed section 45Q credit amounts of \$2,268,000 in 2021, \$2,515,000 in 2022, and \$2,761,000 in 2023 using the statutory rates in §1.45Q-1(d)(3). In 2024, A captured and sold another 100,000 metric tons of carbon dioxide to B, which B used as a tertiary injectant in a qualified enhanced oil recovery project. In late 2024, B determined that 10,000 metric tons

of carbon dioxide injected during 2021 had leaked from the containment area of the reservoir and will eventually migrate to the atmosphere.

(B) Because the leakage determined in 2024 (10,000 metric tons) did not exceed the amount stored in 2024 (100,000 metric tons), a recapture event did not occur in 2024. A's section 45Q credit for 2024 is \$2,706,300 (net 90,000 metric tons of qualified carbon oxide captured and used as a tertiary injectant multiplied by the statutory credit rate for 2024 of \$30.07).

(ii) *Example 2.* (A) Assume same facts as in Example 1. Additionally, in 2025, B determines that 190,000 metric tons of carbon dioxide injected in 2021 and 2022 have leaked and will eventually migrate to the atmosphere. No injection of carbon dioxide takes place in 2025.

(B) Because the leakage determined in 2025 (190,000 metric tons) exceeds the amount stored in 2025 (0 metric tons), a recapture event occurred in 2025. A's credit for 2025 is \$0 because the net amount of carbon dioxide captured and used as a tertiary injectant in 2025 was 0 metric tons. The 2025 recapture amount is calculated by multiplying the 190,000 metric tons of recaptured qualified carbon oxide by the appropriate statutory credit rate using the LIFO method. The first 90,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2024, and is recaptured at the 2024 statutory rate of \$30.07 per metric ton. The remaining 100,000 metric tons of recaptured qualified carbon oxide are deemed attributable to 2023. The credits attributable to 2023 are recaptured at the 2023 statutory rate of \$27.61 per metric ton. Thus, the total recapture amount is \$5,467,300, and is added to A's tax due for 2025.

(iii) *Example 3.* (A) Assume the same facts as in Example 2, except that A sells Facility X to C on January 1, 2024. C sells 100,000 metric tons of carbon dioxide captured by Facility X to B for use as a tertiary injectant in a qualified enhanced oil recovery project. Thus, C claims a section 45Q credit in 2024 of \$2,706,300 (net 90,000 metric tons of qualified carbon oxide captured and used as a tertiary injectant multiplied by the statutory credit rate for 2024 of \$30.07).

(B) The total recapture amount in 2025 is the same \$5,467,300 as in Example 2, but is allocated between A and C. The first 90,000 metric tons of recaptured qualified carbon oxide are deemed attributable to 2024. The credits that are attributable to 2024 are recaptured at the 2024 statutory rate of \$30.07 per ton (for a recapture amount of \$2,706,300). Because C claimed that amount of section 45Q credit in 2024, a recapture amount of \$2,706,300 is added to C's tax due for 2025. The remaining 100,000 metric tons of recaptured qualified carbon oxide are deemed attributable to 2023. The credits that are attributable to 2023 are recaptured at the 2023 statutory rate of \$27.61 per ton (for a recapture amount of \$2,761,000). Because A claimed that amount of section 45Q credit in 2023, a recapture amount of \$2,761,000 is added to A's tax due for 2025.

(iv) *Example 4.* (A) Assume the same facts as in Example 2, except that in 2023 A made a section 45Q(f)(3)(B) election to allow B to claim one-half of the section 45Q credit for 2023. A and B each claimed \$1,380,500 of section 45Q credit in 2023

(50,000 metric tons each multiplied by the 2023 statutory rate of \$27.61).

(B) The total recapture amount in 2025 is the same \$5,467,300 as in Example 2, but is allocated among A and B. The first 90,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2024. The section 45Q credit amounts attributable to 2024 are recaptured at the 2024 statutory rate of \$30.07 per ton (for a recapture amount of \$2,706,300). Because A claimed that amount of section 45Q credit in 2024, \$2,706,300 is added to A's tax due for 2025. The remaining 100,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2023. The section 45Q credit amounts attributable to 2023 are recaptured at the 2023 statutory rate of \$27.61 per ton (for a recapture amount of \$2,761,000). Because A and B each claimed half of that amount (\$1,380,500) of section 45Q credit in 2023, \$1,380,500 is added to both A's and B's tax due for 2025.

(v) *Example 5.* (A) Assume the same facts as in Example 2, except that the 100,000 metric tons of carbon dioxide sold to B in 2021, 2022, 2023, and 2024 for use as a tertiary injectant in a qualified enhanced oil recovery project were captured equally (50,000 metric tons per year) from qualified facilities owned by J and K. Neither J nor K made a section 45Q(f)(3)(B) election to allow B to claim the credit.

(B) Because the leakage determined in 2024 (10,000 metric tons) did not exceed the amount used as a tertiary injectant in 2024 (100,000 metric tons) a recapture event did not occur in 2024. The total amount of section 45Q credit for 2024 is \$2,706,300 (net 90,000 metric tons of qualified carbon oxide captured and used as a tertiary injectant multiplied by the statutory credit rate for 2024 of \$30.07). J and K may each claim half of this amount of section 45Q credit (\$1,353,150) in 2024.

(C) The total recapture amount in 2025 is the same \$5,467,300 as in Example 2, but is allocated between J and K. The section 45Q credit amounts relating to the first 90,000 metric tons of recaptured qualified carbon oxide are deemed attributable to 2024 and are recaptured at the 2024 statutory rate of \$30.07 per ton (for a recapture amount of \$2,706,300). Because J and K each claimed half of that amount (\$1,353,150) of section 45Q credit in 2024, \$1,353,150 is added to both J's and K's tax due for 2025. The section 45Q credit amounts relating to the remaining 100,000 metric tons of recaptured qualified carbon oxide are deemed attributable to 2023 and are recaptured at the 2023 statutory rate of \$27.61 per ton (for a recapture amount of \$2,761,000). Because J and K each claimed half of that amount (\$1,380,500) of section 45Q credit in 2023, an additional \$1,380,500 is added to both J's and K's tax due for 2025. Thus, a total recapture amount of \$2,733,650 is added to both J's and K's tax due for 2025.

(vi) *Example 6.* (A) M owns Industrial Facility Z. No other taxpayer has ever owned Z, and M has never allowed another taxpayer to claim any section 45Q credits with respect to qualified carbon oxide captured from Z. M captured 1,000,000 metric tons of carbon dioxide annually in each of 2017, 2018,

2019, 2020, 2021, 2022, 2023, 2024, and 2025. All captured carbon dioxide was sold to N for use as a tertiary injectant in a qualified enhanced oil recovery project. N provided contractual assurance that the carbon dioxide would be sequestered in secure geological storage. M claimed section 45Q credit amounts of \$12,830,000 in 2017, \$15,209,000 in 2018, \$17,760,000 in 2019, \$20,220,000 in 2020, \$22,680,000 in 2021, \$25,150,000 in 2022, \$27,610,000 in 2023, \$30,070,000 in 2024, and \$32,540,000 in 2025 using the statutory rates in §1.45Q-1(d)(3). No injection of carbon oxides takes place in 2026. In 2026, N determined that 6,200,000 metric tons of carbon dioxide previously injected had leaked from the containment area of the reservoir and will eventually migrate to the atmosphere.

(B) Because the leakage determined in 2025 (6,200,000 metric tons) exceed the amount stored in 2026 (0 metric tons) a recapture event occurred in 2026. A's credit for 2026 is \$0 because the net amount of carbon dioxide captured and used as a tertiary injectant in 2026 was 0 metric tons. The 2026 recapture amount is calculated by multiplying the 6,200,000 metric tons of recaptured qualified carbon oxide by the appropriate statutory credit rate using the LIFO method. The first 1,000,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2025, and is recaptured at the 2025 statutory rate of \$32.54 per metric ton. The next 1,000,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2024, and is recaptured at the 2024 statutory rate of \$30.07 per metric ton. The next 1,000,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2024, and is recaptured at the 2023 statutory rate of \$27.16 per metric ton. The next 1,000,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2022, and is recaptured at the 2022 statutory rate of \$25.15 per metric ton. The next 1,000,000 metric tons of recaptured qualified carbon oxide is deemed attributable to 2021, and is recaptured at the 2021 statutory rate of \$22.68 per metric ton. The remaining 1,200,000 metric tons are not subject to recapture because of the five-year lookback limit in §1.45Q-1(g)(2). Thus, the total recapture amount is \$138,050,000, and is added to A's tax due for 2026.

(h) *Recapture in the event of intentional removal from storage.* If qualified carbon oxide for which a credit has been claimed is deliberately removed from a secure geological storage site, then a recapture event would occur in the year in which the qualified carbon oxide is removed from the storage site pursuant to §1.45Q-5(a).

(i) *Limited exceptions.* A recapture event is not triggered in the event of a loss of containment of qualified carbon oxide resulting from actions not related to the selection, operation, or maintenance of the storage facility, such as volcanic activity or terrorist attack.

(j) *Applicability date.* This section applies to taxable years beginning after [INSERT DATE FINAL REGULATIONS ARE PUBLISHED IN THE Federal

**Register.]** Taxpayers may choose to apply this section for taxable years beginning on or after February 9, 2018, provided the taxpayer applies this section and sections 1.45Q-1, 1.45Q-2, 1.45Q-3, and 1.45Q-4 in their entirety and in a consistent manner.

*Deputy Commissioner for Services and Enforcement.*

(Filed by the Office of the Federal Register on May 29, 2020, 11:15 a.m., and published in the issue of the Federal Register for June 2, 2020, 85 FR 34050.)

## Notice of Proposed Rulemaking

### Statutory Limitations on Like-Kind Exchanges

#### REG-117589-18

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed regulations provide guidance under the Internal Revenue Code (Code) to implement recent changes enacted in the Tax Cuts and Jobs Act. The proposed regulations amend the existing regulations to add a definition of real property to reflect statutory changes limiting section 1031 to exchanges of real property. The proposed regulations also provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in the exchange. The proposed regulations affect taxpayers that exchange business or investment property for other business or investment property and that must determine whether the exchanged properties are real property for purposes of section 1031.

DATES: Written or electronic comments and requests for a public hearing must be received by August 11, 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 <https://www.regulations.gov> (indicate IRS and REG-117589-18) 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 submitted electronically, and to the extent practicable on paper, to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG-117589-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Edward C. Schwartz, (202) 317-4740; concerning submissions of comments and outlines of topics, or requests for a public hearing, Regina L. Johnson, (202) 317-5177 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

###### I. Overview

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1, as revised April 1, 2019) under section 1031 of the Code (current regulations). The proposed amendments to the current regulations (proposed regulations) implement statutory amendments to section 1031 made by section 13303 of Public Law 115-97 (131 Stat. 2054), commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 13303(c) of the TCJA amended section 1031 to limit its application to exchanges of real property for exchanges completed after December 31, 2017, subject to a trans-

sition rule for certain exchanges in which property had been transferred before January 1, 2018. To implement these statutory changes, the proposed regulations would limit the application of the like-kind exchange rules under section 1031 to exchanges of real property and adapt an existing incidental property exception to apply to a taxpayer's receipt of personal property that is incidental to real property the taxpayer receives in the exchange.

## II. Section 1031 after the TCJA

As amended by the TCJA, section 1031(a) provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment (relinquished real property) if the relinquished real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment (replacement real property). However, left unchanged by the TCJA, section 1031(b) provides that a taxpayer must recognize gain on the receipt of money and non-like-kind property in an exchange.

## III. Current regulations regarding "like kind"

Although the TCJA removed personal and certain intangible property from eligibility for like-kind exchange treatment, the need to determine whether the relinquished real property and the replacement real property are of a like kind continues to exist after the changes to section 1031 made by the TCJA. Current §1.1031(a)-1(b) provides that "like kind" refers to the nature or character of the real property and not to its grade or quality. Real property of one kind or class may not, under section 1031, be exchanged for real property of a different kind or class. The fact that any real property involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the real property and not to its kind or class. Under current §1.1031(a)-1(c), examples of exchanges of real property of a like kind include an exchange: by a non-dealer of city real estate for a farm or ranch; of improved real estate for unimproved real estate; and of a leasehold interest in a fee

with 30 years or more to run for real estate.

## IV. Identification of exchanged properties

Under section 1031(a)(3), unchanged by the TCJA, real property a taxpayer receives in an exchange is not like-kind property unless, within 45 days of the taxpayer's transfer of the relinquished real property, the real property is identified as replacement real property to be received in the exchange. Under current §1.1031(k)-1(c)(4), the maximum number of properties a taxpayer may identify as replacement real property is three properties, without regard to the fair market value of the properties, or any number of properties as long as the aggregate fair market value of the properties does not exceed 200 percent of the aggregate fair market value of the relinquished real property. Current § 1.1031(k)-1(c)(5) provides that, for purposes of the identification rules, property that is incidental to a larger item of property is not treated as property separate from the larger item if, in standard commercial transactions, the property is typically transferred with the larger item of property, and the aggregate fair market value of all of the incidental property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

## V. Recognition of gain or loss on actual or constructive receipt of non-like-kind property

Under current §1.1031(k)-1(f)(1), if a taxpayer actually or constructively receives money or property that is not of a like kind to the taxpayer's relinquished real property (other property) before the taxpayer receives like-kind replacement real property, gain or loss may be recognized. In addition, if the money or other property the taxpayer receives is in the full amount of the consideration for the relinquished real property, the transaction is a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement real property.

Current §1.1031(k)-1(g)(2) through (5) provides safe harbors, the use of which result in a taxpayer not being considered in actual or constructive receipt of

money or other property. Under current §1.1031(k)-1(g)(4)(i), in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a) and the determination of whether the taxpayer is in actual or constructive receipt of money or other property is made as if the qualified intermediary is not the agent of the taxpayer. However, current §1.1031(k)-1(g)(4)(i) applies only if, pursuant to the requirements of current §1.1031(k)-1(g)(6)(i), the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary.

Under current §1.1031(k)-1(g)(7), in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property are expressly limited as provided in current §1.1031(k)-1(g)(6), the taxpayer's receipt of or right to receive items that a seller may receive as a consequence of the disposition of property and that are not included in the amount realized from the disposition of property (for example, prorated rents) are disregarded. Also disregarded are transactional items that relate to the disposition of the relinquished property or to the acquisition of the replacement property and appear under local standards in the typical closing statements as the responsibility of a buyer or seller, such as commissions, prorated taxes, recording or transfer taxes, and title company fees.

## Explanation of Provisions

### I. Definition of Real Property

#### A. Approach of the proposed regulations

The determination of whether property is real property has taken on additional significance as a result of the TCJA amendments limiting like-kind exchange treatment under section 1031 to exchanges of real property. Prior to enactment of the TCJA, neither the Code nor the Income Tax Regulations provided a definition of the term "real property" for

purposes of section 1031. The Treasury Department and the IRS have determined that regulations providing guidance on whether property is real property under section 1031 are needed because taxpayers need certainty regarding whether any part of the replacement property received in an exchange is non-like-kind property subject to the gain recognition rules of section 1031(b).

The legislative history to the TCJA provides that real property eligible for like-kind exchange treatment under pre-TCJA law should continue to be eligible for like-kind exchange treatment after the enactment of the TCJA. The legislative history further provides that real property under section 1031 includes shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) of the Code if the state in which the company is organized views the shares of the company as real property. Similarly, improved real estate and unimproved real estate are generally considered to be property of a like kind. H. Rept. 115-466, at 396, fn. 726 (2017) (Conference Report). These proposed regulations define the term “real property” for purposes of section 1031 in a manner consistent with the scope described by Congress in the Conference Report.

Various Income Tax Regulations provide definitions of real property for purposes of applying Code sections other than section 1031. For example, §1.263(a)-3(b) generally defines real property for purposes of the requirement to capitalize amounts paid to acquire, produce, or improve tangible property under section 263(a) by reference to §§1.48-1(c) and (d). Section 1.263A-8(c) provides a definition of real property for purposes of determining whether interest expense relating to the production of designated property must be capitalized under the rules in §1.263A-8. Section 1.1250-1(e)(3) defines real property for purposes of determining depreciation or amortization recapture upon the disposition of certain property. Specifically, §1.1250-1(e)(3) uses section 48 principles for the definition of real property through its reference to the rules in §1.1245-3(c). Section 1.856-10 provides a definition of real property for determining whether a corporation qualifies as a real estate investment trust (REIT) under sec-

tions 856 through 859 of the Code. Section 1.897-1(b) defines real property for purposes of section 897, which treats gain or loss from a foreign person’s disposition of a U.S. real property interest as income effectively connected with a U.S. trade or business.

Although there are many similarities in the way various sections of the Code, and the regulations under those sections, define “real property,” there are also differences in those definitions that reflect the different purposes underlying those provisions. Certain sections of the Code and Income Tax Regulations apply broad definitions and sets of rules for the definition of real property, while others apply narrower definitions. For example, §1.1250-1(e)(3) uses a narrow definition of real property, which is relied upon for purposes of applying section 168 and former section 38. Under section 168, a tangible asset that is personal property, as opposed to real property, generally is depreciated at a faster rate than real property is depreciated. See section 168(c) and (g) (2)(C). Under former section 38, the investment tax credit applied to qualified investment in depreciable property (section 38 property) described in former section 48(a), which primarily included tangible personal property and excluded real property. See §§1.48-1(c) and (d). In contrast, section 897 uses a broad definition of real property that includes items of personal property that are associated with the use of real property. See section 897(c)(6)(B) (real property includes movable walls, furnishings, and other personal property associated with the use of the real property). Under section 897, an item of property may be treated as a U.S. real property interest under the Foreign Investment in Real Property Act provisions, notwithstanding that it is characterized as personal property for other purposes of the Code. In the context of REITs under sections 856 through 859, the regulations defining real property set forth a broader definition for purposes of satisfying the REIT quarterly asset test. The regulations under section 856 were based in part on the particular policies underlying the REIT provisions, and apply only for purposes of the REIT provisions.

The Treasury Department and the IRS have concluded that it would not be appro-

priate to adopt wholesale as the definition of real property for purposes of section 1031 an existing definition of real property from another section of the Code or regulations due to the varying purposes of each of the provisions of the Code, and the intent of Congress that real property eligible for like-kind exchange treatment under pre-TCJA law should continue to be eligible for like-kind exchange treatment in years beginning after 2017. Using the definition of real property in §1.263(a)-3(b), §1.263A-8(c), §1.1250-1(e), or other regulations discussed in this **Explanation of Provisions**, would be inappropriate because, for example, certain shares in a mutual ditch, reservoir, or irrigation company are real property eligible for like-kind exchange treatment under pre-TCJA law, but would not be real property under some of the other regulations. Similarly, §1.856-10 provides that property having an active function such as producing, manufacturing, or creating a product is not real property under section 856, but nothing in pre-TCJA section 1031 law suggests that real property held for productive use in a trade or business or for investment should necessarily be excluded from the definition of real property because of an active rather than passive function.

Thus, instead of a wholesale adoption of an existing real property definition used in another Code or regulations section, these proposed regulations incorporate certain aspects from existing regulatory definitions of real property that are consistent with the legislative history underlying the TCJA amendment to section 1031 indicating that real property eligible for like-kind exchange treatment under pre-TCJA law should continue to be eligible for like-kind exchange treatment after the enactment of the TCJA. See, for example, §§1.263(a)-3(b)(3) and 1.856-10 defining the term “real property” to mean land and improvements to land such as buildings and other inherently permanent structures, and their structural components, and providing that local law is not controlling for purposes of determining whether property is real property under that section; §1.263A-8(c) providing that real property includes unsevered natural products of land such as growing crops and plants, mines, wells, and other natural deposits; and §1.856-10(c) providing, in

relevant part, that the term “land” includes “water and air space superjacent to land.”

#### B. Proposed definition of real property

Under the proposed regulations, real property includes land and improvements to land, unsevered crops and other natural products of land, and water and air space superjacent to land. Improvements to land include inherently permanent structures and the structural components of inherently permanent structures. The proposed regulations also provide that local law definitions generally are not controlling in determining the meaning of the term “real property” for purposes of section 1031. This real property definition language is very similar to the language in most of the other regulatory provisions previously mentioned, including the regulations under section 48, section 263(a), and section 263A. The definition under the proposed regulations, however, includes differences necessary for the proper application of section 1031.

These proposed regulations provide that each distinct asset must be analyzed separately from any other assets to which the asset relates to determine if the asset is real property, whether as land, an inherently permanent structure, or a structural component of an inherently permanent structure. Items that are specifically listed in these proposed regulations as buildings and other inherently permanent structures are distinct assets. Assets and systems specifically listed in these proposed regulations as types of structural components also are treated as distinct assets. Other distinct assets are identified using factors provided by these proposed regulations. All listed factors must be considered, and no one factor is determinative. These rules are based on similar rules concerning distinct assets in §1.856-10(e).

The proposed regulations provide that inherently permanent structures include any building or other structure that is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time. For this purpose, the proposed regulations define a “building” as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to

provide working, office, parking, display, or sales space. “Buildings” also include the following distinct assets if permanently affixed: houses, apartments, hotels, motels, enclosed stadiums and arenas, enclosed shopping malls, factory and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores. The definition of building and the examples of buildings in the proposed regulations are derived from §1.48-1(e)(1) and §1.856-10(d)(2)(ii)(B).

The proposed regulations also provide a list of structures that qualify as inherently permanent structures. If property is not included in the list of inherently permanent structures, the proposed regulations provide factors that must be used to determine whether the property is an inherently permanent structure for purposes of section 1031. These factors are similar to the factors in §1.856-10(d)(2)(iv).

Under the proposed regulations, property that is in the nature of machinery or is essentially an item of machinery or equipment is generally not an inherently permanent structure and not real property under section 1031. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a structural component, the machinery is real property if it serves the inherently permanent structure and does not produce or contribute to the production of income other than for the use or occupancy of space. These rules regarding machinery are very similar to the rules in §1.263A-8(c)(4) and §1.856-10(d)(3).

Under the proposed regulations, structural components of inherently permanent structures are improvements to land and thus real property for purposes of section 1031. A structural component is any distinct asset that is a constituent part of, and integrated into, an inherently permanent structure. If interconnected assets work together to serve an inherently permanent structure (for example, systems that provide a building with electricity, heat, or water), the assets are analyzed together as one distinct asset that may qualify as a structural component. For example, a gas line that provides fuel to a building’s heating system comprises a part of the structural component that is the heating system, and therefore qualifies as real property for

section 1031 purposes. However, if the purpose of a gas line is to provide fuel to business equipment in a building, such as fryers and ovens in a building utilized as a restaurant, the gas line is not a constituent part of an inherently permanent structure and therefore not real property for section 1031 purposes. Comments are requested on whether the function of a distinct asset that is not machinery is appropriate to use as the basis for determining whether the asset qualifies as real property for section 1031 purposes.

A structural component may qualify as real property only if the taxpayer holds its interest in the structural component together with a real property interest within the physical space of the inherently permanent structure served by the structural component. If a distinct asset is customized in connection with the rental of space in or on an inherently permanent structure to which the asset relates, the customization does not affect whether the distinct asset is a structural component.

The proposed regulations also contain a list of properties that are structural components for purposes of section 1031. For components not included in the list, the proposed regulations provide factors for determining whether the component is a structural component of a building or inherently permanent structure and thus real property for section 1031 purposes. The proposed regulations also address tenant improvements to a building that are inherently permanent or otherwise classified as real property and property produced for sale that is not real property in the hands of the producing taxpayer or a related person. The rules in the proposed regulations relating to structural components are similar to the rules in many of the other regulations discussed in this preamble.

The proposed regulations provide that unsevered natural products of land generally are treated as real property under section 1031. This includes growing crops, plants, and timber; mines; wells; and other natural deposits. Natural products and deposits, such as crops, timber, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land.

The proposed regulations also address instances in which intangible property is considered real property under section

1031. An intangible asset is real property or an interest in real property for purposes of section 1031 to the extent it derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space. For instance, a license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure, and that is in the nature of a leasehold, easement, or fee ownership, generally is an interest in real property for purposes of section 1031.

Under the proposed regulations, a license or permit to engage in or operate a business on real property is not real property or an interest in real property for purposes of section 1031 if the license or permit produces or contributes to the production of income other than consideration for the use and occupancy of space. The rules in the proposed regulations relating to intangible assets are similar to the rules in §1.856-10(f) and are consistent with pre-TCJA law concerning whether an intangible asset is real property for section 1031 purposes. See *Commissioner v. Crichton*, 122 F.2d 181 (5th Cir. 1941), concluding that an interest in mineral rights is real property for section 1031 purposes, *Peabody Natural Resources Co. v. Commissioner*, 126 T.C. 261 (2006), holding that coal supply contracts were real property for section 1031 purposes, and Rev. Rul. 68-331, 1968-1 C.B. 352, holding that the interest of a lessee in a producing oil lease is an interest in real property for section 1031 purposes.

These proposed regulations define real property only for purposes of section 1031. Consequently, the proposed regulations provide that no inference should be drawn from the section 1031 definition of real property for any purpose outside of section 1031, including for the classification of property for depreciation, whether depreciation recapture applies, or defining an asset for disposition purposes under section 168 and the regulations under section 168.

The Treasury Department and the IRS request comments regarding the definition of real property set forth in these proposed regulations. In particular, the Treasury Department and the IRS request comments

regarding the proposed relevant factors and analysis for determining the qualification of an item as real property.

## II. Incidental Personal Property

The Treasury Department and the IRS are aware that taxpayers have questioned the effect of the receipt of personal property that is incidental to the taxpayer's replacement real property in an intended section 1031 exchange. For example, taxpayers have asked whether an exchange fails to meet the requirements of §1.1031(k)-1(g)(6)(i) if funds from the transfer of relinquished property held by the qualified intermediary are used to acquire an office building, including the personal property in the office building. Taxpayers and qualified intermediaries are concerned that a taxpayer would be considered to be in constructive receipt of all of the exchange funds held by the qualified intermediary if the taxpayer is able to direct the qualified intermediary to use those funds to acquire property that is not of a like kind to the taxpayer's relinquished property. Under §1.1031(k)-1(a), if a taxpayer actually or constructively receives the funds held by a qualified intermediary before receiving the replacement property, the transaction is a sale and not a section 1031 like-kind exchange.

In response to these inquiries, the proposed regulations add to the items in §1.1031-1(g)(7) that are disregarded in determining whether the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary. The proposed regulations provide that personal property that is incidental to replacement real property is disregarded in determining whether a taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by a qualified intermediary are expressly limited as provided in §1.1031(k)-1(g)(6). Personal property is incidental to real property acquired in an exchange if, in standard commercial transactions, the personal property is typically transferred together with the real property, and the aggregate fair market value of the incidental personal property transferred with the real property

does not exceed 15 percent of the aggregate fair market value of the replacement real property. This incidental property rule in the proposed regulations is based on the existing rule in §1.1031(k)-1(c)(5), which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property under section 1031(a)(3)(A) and §1.1031(k)-1(c).

The Treasury Department and the IRS request comments regarding the proposed treatment of a taxpayer's receipt of personal property that is incidental to the taxpayer's replacement real property in an intended section 1031 exchange. In addition, the Treasury Department and the IRS request comments regarding the two-factor analysis for determining whether personal property is incidental to real property acquired in such an exchange. In particular, comments are requested with regard to the appropriateness of the proposed 15-percent fair market value limit set forth in that test for personal property transferred with real property.

## III. Outdated Regulations

The Treasury Department and the IRS request comments regarding whether existing regulations under section 1031 that apply to tax years before the TCJA amendments to section 1031 limiting its application to exchanges of real property should be removed.

## Proposed Applicability Date

These proposed regulations apply to exchanges beginning on or after the date the regulations are published as final regulations in the **Federal Register**. Pending issuance of the final regulations, a taxpayer may rely on these proposed regulations, if followed consistently and in their entirety, for exchanges of real property beginning after December 31, 2017, and before the final regulations are published.

## Special Analyses

### I. Regulatory Planning and Review – Economic Analysis

Executive Orders 12866, 13563 and 13771 direct agencies to assess costs and

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

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

#### A. Background

##### 1. Like-Kind Exchange

Prior to the amendment of section 1031 by the TCJA, certain exchanges of personal, intangible, or real property held for use in a trade or business or for investment qualified for nonrecognition under section 1031. Section 13301 of the TCJA generally limits the application of like-kind exchange treatment to exchanges of real property after December 31, 2017, subject to a transition rule applicable to exchanges not completed by January 1, 2018. Specifically, section 1031 provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment if the real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment.

##### 2. Proposed Regulations

The proposed rules provide a definition of real property to distinguish it from personal property, as the TCJA limited the nonrecognition of gain or loss in the case of like-kind exchange to exchanges of real property. The legislative history

to the TCJA provides that real property eligible for like-kind exchange treatment prior to the TCJA should continue to be eligible for like-kind exchange treatment. H. Rept. 115-466, at 396, fn. 726 (2017). Therefore, the Treasury Department and the IRS propose to extract certain portions of the definition of real property from various existing regulations that are consistent with the legislative history underlying the TCJA amendment to section 1031. See, for example, §§1.263(a)-3(b)(3) and 1.856-10 defining the term “real property” to mean land and improvements to land such as buildings and other inherently permanent structures, and their structural components, and providing that local law is not controlling for purposes of determining whether property is real property; §1.263A-8(c) providing that real property includes unsevered natural products of land such as growing crops and plants, mines, wells, and other natural deposits; and §1.856-10(c) providing, in relevant part, that the term “land” includes “water and air space superjacent to land.” Consistent with these existing regulations, the proposed regulations define real property to include land and improvements to land, unsevered crops and other natural products of land, and water and air space superjacent to land. Improvements to land include inherently permanent structures, and the structural components of inherently permanent structures.

The proposed regulations also include a separate rule relating to personal property in an exchange that is incidental to the real property exchanged. Under this rule, personal property is incidental to real property acquired in an exchange if, in standard commercial transactions, the personal property is typically transferred together with the real property, and the aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property. This incidental property rule in the proposed regulations is based on an existing rule in the regulations under 1031, which provides that certain incidental property is ignored in determining whether a taxpayer has properly identified replacement property.

#### 3. No-action Baseline

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

#### 4. Economic Analysis of Regulation

In general, the proposed regulations use existing definitions of real property in the Income Tax Regulations to define real property under section 1031 so that like-kind exchanges of real property that took place prior to the TCJA would qualify for like-kind exchange treatment after the passage of the TCJA, which is consistent with the legislative history of the TCJA. In addition, taxpayers are familiar with the approach in the proposed regulations concerning incidental personal property, which is consistent with rules regarding identification of replacement property under existing section 1031 regulations.

The statutory changes made by the TCJA to section 1031 limit like-kind exchanges to real property. Consistent with longstanding regulations under section 1031, in determining whether a taxpayer has actual or constructive receipt of money or other property held by a qualified intermediary, the proposed regulations disregard certain incidental personal property. Specifically, the proposed regulations disregard incidental personal property that (1) in standard commercial transactions is typically transferred together with the real property, and (2) does not exceed 15 percent of the aggregate fair market value of the replacement real property. Nonetheless, under section 1031(b), a taxpayer must recognize gain on the receipt of the incidental personal property, which is non-like-kind property. The proposed 15-percent limitation is responsive to ordinary-course exchanges that often commingle personal property and real property as part of the aggregate exchanged property.

With regard to a limitation in excess of 15 percent, the Treasury Department determined that a higher limit might induce taxpayers to bundle more personal property with their exchanged property. Such a result would lead to increased amounts of personal property exchanged with real

property under section 1031 and effectively unlock a class of personal property that would no longer be “incidental” to the real property. With regard to a lower limit, the Treasury Department has determined that the burden of accurately measuring the separate costs of comingled personal and real property would increase.

In addition, the proposed 15 percent incidental personal property limitation would reduce the cost of investing in real property, when compared to no exchanges for incidental personal property. Raising this limit, however, would further increase the tax incentives for investing in such property, although most taxpayers will be indifferent when exchanging incidental property, plants, and equipment with a depreciable life of 20 years or less that is eligible for 100 percent additional first year depreciation, commonly referred to as “bonus depreciation.” Under 100 percent bonus depreciation, gains from the sale of property can be offset by deductions for investment in other qualifying property. Qualifying property acquired after September 27, 2017, and placed in service after September 27, 2017, and generally before January 1, 2023, qualifies for full bonus depreciation. The bonus depreciation rate is phased down 20 percent a year for property placed in service after this date. In the absence of 100 percent bonus depreciation, expanding incentives for like-kind exchange through a higher incidental personal property limitation could also distort investment decisions within and across industries leading to over-investment in like-kind properties relative to consistent treatment across properties. The Treasury Department requests comments and information that would help further inform the analysis underlying the proposed 15-percent limitation for incidental personal property.

The Treasury Department and the IRS have determined that these rules will not have a significant effect on the market for like-kind exchanges of real property. Finally, these proposed regulations do not significantly affect compliance burdens

as the regulations are substantially similar to existing regulations affecting like-kind exchanges for real property.

## II. Paperwork Reduction Act

The collection of information in these proposed regulations is reflected in the collection of information for Form 8824, Like-Kind Exchanges, which has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control numbers 1545-0074. The number of respondents to Form 8824 for tax year 2018 is estimated at 125,000–220,000. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for taxpayers who file Form 8824, which has not changed as a result of these proposed regulations, is shown below.

Recordkeeping . . . . .	10 hr., 16 min.
Learning about the law or the form . . . . .	1 hr., 59 min.
Preparing the form . . . . .	2 hr., 14 min.

Form 8824 is used by taxpayers engaging in section 1031 like-kind exchanges. Beginning after December 31, 2017, section 1031 like-kind exchange treatment applies only to exchanges of real property held for use in a trade or business or for investment, other than real property held primarily for sale. Before the law change, section 1031 also applied to certain exchanges of personal or intangible property. These proposed regulations provide a definition of real property for purposes of section 1031 and a rule for the receipt of personal property that is incidental to real property received in an exchange, and makes conforming changes to the regulations. The law change reflected in the pro-

posed regulations will result in fewer taxpayers engaging in section 1031 like-kind exchanges. This decrease in burden will be reflected in the updated burden estimates for the Form 8824. The requirement to maintain records to substantiate information on the Form 8824 is already contained in the burden associated with the control numbers for those forms and remains unchanged. For purposes of the Paperwork Reduction act, no burden estimates specific to the proposed regulations are currently available. The Treasury Department has not estimated the burden, including that of any new information collections, related to the requirements under the proposed regulations. Those estimates would capture both changes made by the TCJA and those that arise out of discretionary authority exercised in the proposed regulations.

The current status of the Paperwork Reduction Act submissions related to 1031 is provided in the following table. The 1031 provisions are included in aggregated burden estimates for OMB control number 1545-0074, which represents a total estimated burden time, including all related forms and schedules, of 1.784 billion hours and total estimated monetized costs of \$31.764 billion (\$2017). The burden estimates provided in the OMB control numbers below are aggregate amounts that relate to the entire package of forms associated with the OMB control number, and will in the future include but not isolate the estimated burden of only the 1031 requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the proposed regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against over-counting the burden that tax provisions imposed prior to the Act. 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](http://www.irs.gov/draftforms).

Form 8824	Individual (NEW Model) 1545-0074	Sixty-day notice published in the Federal Register on 9/30/19 (84 FR 51712). Public Comment period closed on 11/29/19. Thirty-day notice published in the Federal Register on 12/18/19 (84 FR 69458). Comment period closed on 1/17/20. Approved by OMB through 1/31/2021.
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Link: <https://www.federalregister.gov/documents/2019/12/18/2019-27285/agency-information-collection-activities-submission-for-omb-review-comment-request-us-individual>

Form 8824 is also used by members of the executive branch of the Federal Government and judicial officers of the Federal Government to elect to defer gain under section 1043 on certain sales of property due to potential conflicts of interest arising from their status as government officials. These proposed regulations do not address or affect the deferral of gain on sales under section 1043.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

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 return information are confidential, as required by 26 U.S.C. 6103.

### *III. Regulatory Flexibility Act*

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 Regulatory Flexibility Act (5 U.S.C. chapter 6).

These proposed regulations update existing regulations under section 1031 to reflect statutory changes made to section 1031 by the TCJA. Section 1031 provides that a taxpayer exchanging investment property or property held for productive use in a trade or business for other investment or trade or business property recognizes gain only to the extent of money or other non-like-kind property received in the exchange, and recognizes no loss on the exchange. Under the TCJA amendments to section 1031, for years after 2017, section 1031 applies only to exchanges of real property and no longer applies to exchanges of personal property and certain intangible property. The proposed regulations provide a definition of real property to be used in determining whether a taxpayer has met the requirements of section 1031. In so doing, the proposed regulations follow the legislative history underlying the TCJA amendment to section 1031 providing that real property eligible for like-kind exchange treatment under pre-TCJA law contin-

ues to be eligible for like-kind exchange treatment in years beginning after 2017. Consequently, the proposed regulations use certain aspects from existing regulatory definitions of real property that are consistent with the legislative history underlying the TCJA amendment to section 1031 requiring that the definition of real property remain the same both before and after enactment of the TCJA. Taxpayers already are familiar with these rules, which provide that real property includes land, improvements to land, unsevered natural products of land, and water and air space superjacent to land. In addition, the proposed regulations provide a rule addressing a taxpayer's receipt of personal property that is incidental to the real property the taxpayer receives in the exchange that is based on an existing rule in §1.1031(k)-1.

Individuals and business entities that own investment real property or real property held for productive use in a trade or business may engage in a section 1031 exchange. The provisions of section 1031 apply in the same manner to all taxpayers, so the effect of the proposed regulations is the same for taxpayers that are small entities and taxpayers that are not small entities. The small entities potentially impacted by these regulations are businesses organized as corporations (including S corporations), partnerships, and individuals that file a Form 1040 Schedule C for their respective trades or businesses or Form 1040 Schedule E for their rental real estate.

The number of small entities potentially affected by these proposed regulations is unknown but likely substantial because like-kind exchange are entered into by entities of all sizes. Although a substantial number of small entities is potentially affected by these proposed regulations, the Treasury Department and the IRS have concluded that the proposed regulations will not have a significant economic impact on a substantial number of small entities because the costs to comply with these proposed regulations are not significant. This is because for taxpayers still able to engage in section 1031 exchanges, there are no additional forms they are required to file, and there is no new recordkeeping required, to comply with section 1031 as amended by the TCJA and these proposed

regulations. Thus, taxpayers that engage in like-kind exchanges of real property in 2018 and later years won't have any additional burden as compared to taxpayers engaging in like-kind exchanges in years before 2018. Accordingly, it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities.

Notwithstanding this certification, the Treasury Department and the IRS invite comments from the public about the impact of this proposed rule on small entities.

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

### *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. In 2019, that threshold is approximately \$164 million. This proposed rule does not include any 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 proposed rule does not have federalism implications and does not impose substantial, direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

## Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. Any electronic comments submitted, and to the extent practicable any paper comments submitted, will be made available at <http://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 submitted 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.

## Drafting Information

The principal author of these proposed regulations is Edward C. Schwartz of the Office of Associate Chief Counsel (Income Tax and Accounting). 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 continues to read in part as follows:

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

\* \* \* \*

Par. 2. Section 1.168(i)-1 is amended by:

1. In the last sentence in paragraph (e)(2)(viii)(A), removing “does not apply.” at the end of the sentence and adding “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in its place;

2. In the first sentence in paragraph (m)(1), removing the word “This” at the beginning of the sentence and adding “Except as provided in paragraph (m)(5) of this section, this” in its place; and

3. Redesignating paragraph (m)(5) as paragraph (m)(6) and adding new paragraph (m)(5).

The addition reads as follows:

*§1.168(i)-1 General asset accounts.*

\* \* \* \*

(m) \* \* \*

(5) *Application of paragraph (e)(2)(viii)(A).* The language “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in the last sentence of paragraph (e)(2)(viii)(A) of this section applies on or after [EFFECTIVE DATE OF THE FINAL RULE]. Paragraph (e)(2)(viii)(A) of this section as contained in 26 CFR part I edition revised as of April 1, 2019, applies before the effective date of the final rule.

Par. 3. Section 1.168(i)-8 is amended by:

1. In the last sentence in paragraph (c)(4)(i), removing “does not apply.” at the end of the sentence and adding “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in its place;

2. At the beginning of the sentence in paragraph (j)(1), removing the word “This” and adding “Except as provided in paragraph (j)(5) of this section, this” in its place;

3. Redesignating paragraph (j)(5) as paragraph (j)(6) and adding new paragraph (j)(5).

The addition reads as follows:

*§1.168(i)-8 Dispositions of MACRS property.*

\* \* \* \*

(j) \* \* \*

(5) *Application of paragraph (c)(4)(i).* The language “and the distinct asset determination under §1.1031(a)-3(a)(4) do not apply.” in the last sentence of paragraph (c)(4)(i) of this section applies on or af-

ter [EFFECTIVE DATE OF THE FINAL RULE]. Paragraph (c)(4)(i) of this section as contained in 26 CFR part I edition revised as of April 1, 2019, applies before the effective date of the final rule.

Par. 4. Section 1.1031-0 is amended by revising the entry for §1.1031(a)-1(e) and adding entries for §1.1031(a)-3 to read as follows:

*§1.1031-0 Table of contents.*

\* \* \* \*

*§1.1031(a)-1 Property held for productive use in a trade or business or for investment.*

\* \* \* \*

(e) *Applicability dates.*

\* \* \* \*

*§1.1031(a)-3 Definition of real property.*

(a) *Real property.*

(b) *Examples.*

(c) *Applicability date.*

\* \* \* \*

Par. 5. Section 1.1031(a)-1 is amended by adding paragraph (a)(3) and revising paragraph (e) to read as follows:

*§1.1031(a)-1 Property held for productive use in trade or business or for investment.*

(a) \* \* \*

(3) *Exchanges after 2017.* Pursuant to section 13303 of Public Law 115-97 (131 Stat. 2054), for exchanges beginning after December 31, 2017, section 1031 and §§1.1031(a)-1, 1.1031(b)-2, 1.1031(d)-1T, 1.1031(d)-2, 1.1031(j)-1, 1.1031(k)-1, and references to section 1031 in §§1.1031(b)-1, 1.1031(c)-1, and 1.1031(d)-1, apply only to qualifying exchanges of real property (within the meaning of §1.1031(a)-3) that is held for productive use in a trade or business, or for investment, and that is not held primarily for sale.

\* \* \* \*

(e) *Applicability dates—(1) Exchanges of partnership interests.* The provisions of paragraph (a)(1) of this section relating to exchanges of partnership interests apply to transfers of property made by taxpayers on or after April 25, 1991.

(2) *Exchanges after 2017.* The provisions of paragraph (a)(3) of this section apply to exchanges beginning on or after [EFFECTIVE DATE OF THE FINAL RULE].

Par. 6. Section 1.1031(a)-3 is added to read as follows:

*§1.1031(a)-3 Definition of real property.*

(a) *Real property*—(1) *In general.* The term *real property* under section 1031 and §§1.1031(a)-1 through 1.1031(k)-1 means land and improvements to land, unsevered natural products of land, and water and air space superjacent to land. Under paragraph (a)(5) of this section, an interest in real property of a type described in this paragraph (a)(1), including fee ownership, co-ownership, a leasehold, an option to acquire real property, an easement, or a similar interest, is real property for purposes of section 1031 and this section. Except for a state's characterization of shares in a mutual ditch, reservoir, or irrigation company described in paragraph (a)(5)(i) of this section, local law definitions are not controlling for purposes of determining the meaning of the term *real property* under this section.

(2) *Improvements to land*—(i) *In general.* The term *improvements to land* means inherently permanent structures and the structural components of inherently permanent structures.

(ii) *Inherently permanent structures*—  
(A) *In general.* The term *inherently permanent structures* means any building or other structure that is a distinct asset within the meaning of paragraph (a)(4) of this section and is permanently affixed to real property and that will ordinarily remain affixed for an indefinite period of time.

(B) *Building.* A building is any structure or edifice enclosing a space within its walls, and covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. Buildings include the following distinct assets if permanently affixed: houses, apartments, hotels, motels, enclosed stadiums and arenas, enclosed shopping malls, factories and office buildings, warehouses, barns, enclosed garages, enclosed transportation stations and terminals, and stores.

(C) *Other inherently permanent structures.* Inherently permanent structures under this paragraph (a)(2)(ii) include the following distinct assets, if permanently affixed: in-ground swimming pools; roads; bridges; tunnels; paved parking areas, parking facilities, and other pavements; special foundations; stationary wharves and docks; fences; inherently

permanent advertising displays for which an election under section 1033(g)(3) is in effect; inherently permanent outdoor lighting facilities; railroad tracks and signals; telephone poles; power generation and transmission facilities; permanently installed telecommunications cables; microwave transmission, cell, broadcasting, and electric transmission towers; oil and gas pipelines; offshore drilling platforms, derricks, oil and gas storage tanks; grain storage bins and silos; and enclosed transportation stations and terminals. Affixation to real property may be accomplished by weight alone. If property is not listed as an inherently permanent structure in this paragraph (a)(2)(ii)(C), the determination of whether the property is an inherently permanent structure under this paragraph (a)(2)(ii) is based on the following factors—

(1) The manner in which the distinct asset is affixed to real property;

(2) Whether the distinct asset is designed to be removed or to remain in place;

(3) The damage that removal of the distinct asset would cause to the item itself or to the real property to which it is affixed;

(4) Any circumstances that suggest the expected period of affixation is not indefinite; and

(5) The time and expense required to move the distinct asset.

(D) *Machinery.* Property that is in the nature of machinery or is essentially an item of machinery or equipment is generally not an inherently permanent structure and not real property for purposes of this section. In the case, however, of a building or inherently permanent structure that includes property in the nature of machinery as a structural component, the machinery is real property provided it serves the inherently permanent structure and does not produce or contribute to the production of income other than for the use or occupancy of space.

(iii) *Structural components*—(A) *In general.* The term *structural component* means any distinct asset, within the meaning of paragraph (a)(4) of this section, that is a constituent part of, and integrated into, an inherently permanent structure. If interconnected assets work together to serve an inherently permanent structure (for example, systems that provide a building with

electricity, heat, or water), the assets are analyzed together as one distinct asset that may be a structural component. A structural component may qualify as real property only if the taxpayer holds its interest in the structural component together with a real property interest in the space in the inherently permanent structure served by the structural component. If a distinct asset is customized, the customization does not affect whether the distinct asset is a structural component. Tenant improvements to a building that are inherently permanent or otherwise classified as real property within the meaning of this paragraph (a)(2)(iii) are real property under this section. However, property produced for sale, such as bricks, nails, paint, and windowpanes, that is not real property in the hands of the producing taxpayer or a related person, as defined in section 1031(f)(3), but that may be incorporated into real property by an unrelated buyer, is not treated as real property by the producing taxpayer.

(B) *Examples of structural components.* Structural components include the following items, provided the item is a constituent part of, and integrated into, an inherently permanent structure: walls; partitions; doors; wiring; plumbing systems; central air conditioning and heating systems; pipes and ducts; elevators and escalators; floors; ceilings; permanent coverings of walls, floors, and ceilings; insulation; chimneys; fire suppression systems, including sprinkler systems and fire alarms; fire escapes; security systems; humidity control systems; and other similar property. If a component of a building or inherently permanent structure is a distinct asset and is not listed as a structural component in this paragraph (a)(2)(iii)(B), the determination of whether the component is a structural component under this paragraph (a)(2)(iii) is based on the following factors—

(1) The manner, time, and expense of installing and removing the component;

(2) Whether the component is designed to be moved;

(3) The damage that removal of the component would cause to the item itself or to the inherently permanent structure to which it is affixed; and

(4) Whether the component is installed during construction of the inherently permanent structure.

**(3) Unsevered natural products of land.**

Unsevered natural products of land, including growing crops, plants, and timber; mines; wells; and other natural deposits, generally are treated as real property for purposes of this section. Natural products and deposits, such as crops, timber, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land.

**(4) Distinct asset—(i) In general.** A distinct asset is analyzed separately from any other assets to which the asset relates to determine if the asset is real property, whether as land, an inherently permanent structure, or a structural component of an inherently permanent structure. Buildings and other inherently permanent structures are distinct assets. Assets and systems listed as a structural component in paragraph (a)(2)(iii)(B) of this section are treated as distinct assets.

**(ii) Facts and circumstances.** The determination of whether a particular separately identifiable item of property is a distinct asset is based on all the facts and circumstances. In particular, the following factors must be taken into account—

(A) Whether the item is customarily sold or acquired as a single unit rather than as a component part of a larger asset;

(B) Whether the item can be separated from a larger asset, and if so, the cost of separating the item from the larger asset;

(C) Whether the item is commonly viewed as serving a useful function independent of a larger asset of which it is a part; and

(D) Whether separating the item from a larger asset of which it is a part impairs the functionality of the larger asset.

**(5) Intangible assets—(i) In general.** To the extent an intangible asset derives its value from real property or an interest in real property, is inseparable from that real property or interest in real property, and does not produce or contribute to the production of income other than consideration for the use or occupancy of space, the intangible asset is real property or an interest in real property. Real property includes shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) if, at the time of the exchange, the shares have been recognized by the highest court of the State in which the company was organized, or

by a State statute, as constituting or representing real property or an interest in real property.

**(ii) Licenses and permits.** A license, permit, or other similar right that is solely for the use, enjoyment, or occupation of land or an inherently permanent structure and that is in the nature of a leasehold or easement generally is an interest in real property under this section. However, a license or permit to engage in or operate a business on real property is not real property or an interest in real property if the license or permit produces or contributes to the production of income other than consideration for the use and occupancy of space.

**(6) No inference outside of section 1031.** The rules provided in this section concerning the definition of real property apply only for purposes of section 1031. No inference is intended with respect to the classification or characterization of property for other purposes of the Code, such as depreciation and sections 1245 and 1250. For example, a structure or a portion of a structure may be section 1245 property for depreciation purposes and for determining gain under section 1245, notwithstanding that the structure or the portion of the structure is real property under this section. Also, a taxpayer transferring relinquished property that is section 1245 property in a section 1031 exchange is subject to the gain recognition rules under section 1245 and the regulations under section 1245, notwithstanding that the relinquished property or replacement property is real property under this section. In addition, the taxpayer must follow the rules of section 1245 and the regulations under section 1245, and section 1250 and the regulations under section 1250, based on the determination of the relinquished property and replacement property being, in whole or in part, section 1245 property or section 1250 property under those Code sections and not under this section.

**(b) Examples.** The following examples illustrate the provisions of this section.

**(1) Example 1: Natural products of land.** A owns land with perennial fruit-bearing plants that A harvests annually. The unsevered plants are natural products of the land within the meaning of paragraph (a)(3) of this section and thus are real property for purposes of section 1031. A annually harvests fruit from the plants. Upon severance from the land, the harvested fruit ceases to be part of the land and there-

fore is not real property. Storage of the harvested fruit upon or within real property does not cause the harvested fruit to be real property.

**(2) Example 2: Water space superjacent to land.** B owns a marina comprised of U-shaped boat slips and end ties. The U-shaped boat slips are spaces on the water that are surrounded by a dock on three sides. The end ties are spaces on the water at the end of a slip or on a long, straight dock. B rents the boat slips and end ties to boat owners. The boat slips and end ties are water space superjacent to land and thus are real property within the meaning of paragraph (a)(1) of this section.

**(3) Example 3: Indoor sculpture.** (i) C owns an office building and a large sculpture in the atrium of the building. The sculpture measures 30 feet tall by 18 feet wide and weighs five tons. The building was specifically designed to support the sculpture, which is permanently affixed to the building by supports embedded in the building's foundation. The sculpture was constructed within the building. Removal would be costly and time consuming and would destroy the sculpture. The sculpture is reasonably expected to remain in the building indefinitely.

(ii) The sculpture is not an inherently permanent structure listed in paragraph (a)(2)(ii)(C) of this section, and, therefore, C must use the factors provided in paragraphs (a)(2)(ii)(C)(1) through (5) of this section to determine whether the sculpture is an inherently permanent structure. The sculpture—

(A) Is permanently affixed to the building by supports embedded in the building's foundation;

(B) Is not designed to be removed and is designed to remain in place indefinitely;

(C) Would be damaged if removed and would damage the building to which it is affixed;

(D) Is expected to remain in the building indefinitely; and

(E) Would require significant time and expense to move.

(iii) The factors described in paragraphs (a)(2)(ii)(C)(1) through (5) of this section all support the conclusion that the sculpture is an inherently permanent structure within the meaning of paragraph (a)(2)(ii)(A) of this section. Therefore, the sculpture is real property.

**(4) Example 4: Bus shelters.** (i) D owns 400 bus shelters, each of which consists of four posts, a roof, and panels enclosing two or three sides. D enters into a long-term lease with a local transit authority for use of the bus shelters. Each bus shelter is prefabricated from steel and is bolted to the sidewalk. Bus shelters are disassembled and moved when bus routes change. Moving a bus shelter takes less than a day and does not significantly damage either the bus shelter or the real property to which it was affixed.

(ii) The bus shelters are not permanently affixed enclosed transportation stations or terminals, are not buildings under paragraph (a)(2)(ii)(B) of this section, nor are they listed as types of other inherently permanent structures in paragraph (a)(2)(ii)(C) of this section. Therefore, the bus shelters must be analyzed to determine whether they are inherently permanent structures using the factors provided in paragraphs (a)(2)(ii)(C)(1) through (5) of this section. The bus shelters—

(A) Are not permanently affixed to the land or an inherently permanent structure;

(B) Are designed to be removed and not remain in place indefinitely;

(C) Would not be damaged if removed and would not damage the sidewalks to which they are affixed;

(D) Will not remain affixed indefinitely; and

(E) Would not require significant time and expense to move.

(iii) The factors described in paragraphs (a)(2)(ii)(C)(1) through (5) of this section all support the conclusion that the bus shelters are not inherently permanent structures within the meaning of paragraph (a)(2)(ii) of this section. Thus, the bus shelters are not inherently permanent structures within the meaning of paragraph (a)(2)(ii) of this section and, therefore, are not real property.

(5) *Example 5: Industrial 3D Printer.* (i) E owns a building that it uses in its trade or business of manufacturing airplane parts. The building includes an industrial 3D printer that can print airplane wings and an electrical generator that serves the building in a backup capacity. The 3D printer weighs 12 tons and is designed to remain in place indefinitely once installed in the building. The 3D printer was installed during the building's construction. The generator also was installed during construction and is designed to remain in place indefinitely once installed.

(ii) The 3D printer is machinery and, thus, generally not an inherently permanent structure and not real property under paragraph (a)(2)(ii)(D) of this section. In addition, although permanently affixed by virtue of its weight and installed during construction of E's building, the 3D printer produces income other than for the use or occupancy of space. Thus, the 3D printer is not property in the nature of machinery as a structural component within the meaning of paragraph (a)(2)(ii)(D) of this section and, therefore, is not real property.

(iii) The electrical generator serves the entire building and does not generate income other than for the use or occupancy of the building. Thus, the electrical generator is property in the nature of machinery as a structural component within the meaning of paragraph (a)(2)(ii)(D) of this section and, therefore, is real property.

(6) *Example 6: Generator for Industrial 3D Printer.* The facts are the same as in paragraph (b)(5), *Example 5*, except that E installed the electrical generator for the purpose of keeping the industrial 3D printer operating in the event of a power outage. The generator, itself machinery, was installed to serve the operation of machinery and not the building. Thus, the electrical generator is not a structural component within the meaning of paragraphs (a)(2)(ii)(D) and (a)(2)(iii)(A) of this section and, therefore, is not real property.

(7) *Example 7: Raised flooring for Industrial 3D Printer.* (i) The facts are the same as in paragraph (b)(5), *Example 5*, except that E, when installing its 3D printer, also installed a raised flooring system for the purpose of facilitating the operation of the 3D printer. The raised flooring system is not designed or constructed to remain permanently in place. Rather, the raised flooring system can be removed, without any substantial damage to the system itself or to the building, and then reused. The raised flooring was installed during the building's construction.

(ii) The raised flooring system is not integrated into the building as required by paragraph (a)(2)(iii)

(A) of this section and, therefore, is not listed in paragraph (a)(2)(iii)(B) of this section. Thus, the raised flooring must be analyzed to determine whether it is a structural component of E's building (within the meaning of paragraph (a)(2)(iii) of this section) using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The raised flooring—

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal; and

(D) Was installed during construction of the building.

(iii) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section, considered in the aggregate, support the conclusion that the raised flooring is not a structural component of E's building within the meaning of paragraph (a)(2)(iii) of this section. Although the raised flooring was installed during construction of the building, that factor does not outweigh the factors supporting the conclusion that the flooring is not a structural component. Therefore, the raised flooring is not real property under this section.

(8) *Example 8: Steam Turbine.* (i) F owns a building with a large steam turbine attached as a fixture to the building. The steam turbine is a component of a system used for the commercial production of electricity for sale to customers in the ordinary course of F's business as an electric utility. The steam turbine also generates electricity for F's building. The steam turbine takes up a substantial portion of the building and is designed to remain in place indefinitely once installed in F's building. The steam turbine was installed during the construction of the building.

(ii) The steam turbine is machinery and, therefore, generally is not an inherently permanent structure and not real property under paragraph (a)(2)(ii)(D) of this section. Although the steam turbine has characteristics of a structural component because it is permanently affixed, installed during construction of F's building, and serves F's building, the steam turbine is machinery that produces income other than for the use or occupancy of space. Thus, the steam turbine is not an inherently permanent structure within the meaning of paragraph (a)(2)(ii)(D) of this section and, therefore, is not real property.

(9) *Example 9: Partitions.* (i) G owns an office building that it leases to tenants. The building includes partitions owned by G that are used to delineate space within the building. The office building has two types of interior, non-load-bearing drywall partition systems: a conventional drywall partition system (Conventional Partition System) and a modular drywall partition system (Modular Partition System). Neither the Conventional Partition System nor the Modular Partition System was installed during construction of the office building. Conventional Partition Systems are comprised of fully integrated gypsum board partitions, studs, joint tape, and covering joint compound. Modular Partition Systems are comprised of assembled panels, studs, tracks, and exposed joints. Both the Conventional Partition System and the Modular Partition System reach from the floor to the ceiling. In addition, both

are distinct assets as described in paragraph (a)(4) of this section.

(ii) Depending on the needs of a new tenant, the Conventional Partition System may remain in place when a tenant vacates the premises. The Conventional Partition System is integrated into the office building and is designed and constructed to remain in areas not subject to reconfiguration or expansion. The Conventional Partition System can be removed only by demolition, and, once removed, neither the Conventional Partition System nor its components can be reused. Removal of the Conventional Partition System causes substantial damage to the Conventional Partition System itself, but does not cause substantial damage to the building.

(iii) Modular Partition Systems are typically removed when a tenant vacates the premises. Modular Partition Systems are not designed or constructed to remain permanently in place. Modular Partition Systems are designed and constructed to be movable. Each Modular Partition System can be readily removed, remains in substantially the same condition as before, and can be reused. Removal of a Modular Partition System does not cause any substantial damage to the Modular Partition System itself or to the building. The Modular Partition System may be moved to accommodate the reconfigurations of the interior space within the office building for various tenants that occupy the building.

(iv) The Conventional Partition System is comprised of walls that are integrated into an inherently permanent structure and are listed as structural components in paragraph (a)(2)(iii)(B) of this section. Thus, the Conventional Partition System is real property.

(v) The Modular Partition System is not integrated into the building as required by paragraph (a)(2)(iii)(A) of this section and, therefore, is not listed in paragraph (a)(2)(iii)(B) of this section. Thus, the Modular Partition System must be analyzed to determine whether it is a structural component using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The Modular Partition System—

(A) Is installed and removed quickly and with little expense;

(B) Is designed to be moved and is not designed specifically for the particular building of which it is a part;

(C) Is not damaged, and the building is not damaged, upon its removal; and

(D) Was not installed during construction of the building.

(vi) The factors described in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the Modular Partition System is not a structural component of G's building within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the Modular Partition System is not real property.

(10) *Example 10: Pipeline transmission system.* (i) H owns a natural gas pipeline transmission system that provides a conduit to transport natural gas from unrelated third-party producers and gathering facilities to unrelated third-party distributors and end users. The pipeline transmission system is comprised of underground pipelines, isolation valves and vents, pressure control and relief valves, meters, and com-

pressors. Each of these distinct assets was installed during construction of the pipeline transmission system and each was designed to remain permanently in place.

(ii) The pipelines are permanently affixed and are listed as other inherently permanent structures in paragraph (a)(2)(ii)(C) of this section. Thus, the pipelines are real property.

(iii) Isolation valves and vents are placed at regular intervals along the pipelines to isolate and evacuate sections of the pipelines in case there is need for a shut-down or maintenance of the pipelines. Pressure control and relief valves are installed at regular intervals along the pipelines to provide overpressure protection. The isolation valves and vents and pressure control and relief valves are not listed in paragraph (a)(2)(iii) of this section and, therefore, must be analyzed to determine whether they are structural components using the factors provided in paragraphs (a)(2)(iii)(B)(1) through (4) of this section. The isolation valves and vents and pressure control and relief valves—

(A) Are time consuming and expensive to install and remove from the pipelines;

(B) Are designed specifically for the particular pipelines for which they are a part;

(C) Will sustain damage and will damage the pipelines if removed; and

(D) Were installed during construction of the pipelines.

(iv) The factors in paragraphs (a)(2)(iii)(B)(1) through (4) of this section support the conclusion that the isolation valves and vents and pressure control and relief valves are structural components of H's pipelines within the meaning of paragraph (a)(2)(iii) of this section. Therefore, the isolation valves and vents and pressure control and relief valves are real property.

(v) Meters are used to measure the natural gas passing into or out of the pipeline transmission system for purposes of determining the end users' consumption. Over long distances, pressure is lost due to friction in the pipeline transmission system. Compressors are required to add pressure to transport natural gas through the entirety of the pipeline transmission system. Although the meters and compressors were installed during the construction of the pipelines, they are not time consuming and expensive to install and remove from the pipelines; are not designed specifically for the particular pipelines for which they are a part; and their removal does not cause damage to the asset or the pipelines if removed. Thus, the meters and compressors are not structural components within the meaning of paragraph (a)(2)(iii) of this section and, therefore, are not real property.

(11) *Example 11: Land use permit.* J receives a special use permit from the government to place a cell tower on Federal Government land that abuts a Federal highway. Government regulations provide that the permit is not a lease of the land, but is a permit to use the land for a cell tower. Under the permit, the government reserves the right to cancel the permit and compensate J if the site is needed for a higher public purpose. The permit is in the nature of a leasehold that allows J to place a cell tower in a specific location on government land. Therefore, the permit is an interest in real property under paragraph (a)(5) of this section.

(12) *Example 12: License to operate a business.* K owns a building and receives a license from State A to operate a casino in the building. The license applies only to K's building and cannot be transferred to another location. K's building is an inherently permanent structure under paragraph (a)(2)(ii)(A) of this section and, therefore, is real property. However, K's license to operate a casino is not a right for the use, enjoyment, or occupation of K's building, but is rather a license to engage in the business of operating a casino in the building for the production of income. Therefore, the casino license is not real property under paragraph (a)(5) of this section.

(c) *Applicability date.* This section applies to exchanges of real property beginning on or after [EFFECTIVE DATE OF THE FINAL RULE].

Par. 7. Section 1.1031(k)-1 is amended by:

1. Removing “, and” at the end of paragraph (g)(7)(i) and adding a semicolon in its place;

2. Removing the period at the end of paragraph (g)(7)(ii) and adding “; and” in its place;

3. Adding paragraph (g)(7)(iii);

4. In paragraph (g)(8), designating *Examples 1 through 5* as paragraphs (g)(8)(i) through (v), respectively;

5. Further redesignating newly redesignated paragraphs (g)(8)(i)(i) and (ii) as paragraphs (g)(8)(i)(A) and (B);

6. Further redesignating newly redesigned paragraphs (g)(8)(i)(A)(A) and (B) as paragraphs (g)(8)(i)(A)(1) and (2), respectively;

7. Designating the undesignated paragraph immediately following newly redesignated paragraph (g)(8)(i)(A)(2) as paragraph (g)(8)(i)(A)(3);

8. Further redesignating newly redesigned paragraphs (g)(8)(ii)(i) through (iii) as paragraphs (g)(8)(ii)(A) through (C);

9. Further redesignating newly redesigned paragraphs (g)(8)(ii)(A)(A) through (C) as paragraphs (g)(8)(ii)(A)(1) through (3);

10. Further redesignating newly redesigned paragraphs (g)(8)(ii)(A)(1)(1) and (2) as paragraphs (g)(8)(ii)(A)(1)(i) and (ii), respectively;

11. In newly redesignated paragraph (g)(8)(ii)(A)(1)(i), removing “, or” at the end of the paragraph and adding “; or” in its place;

12. Designating the undesignated paragraph immediately following newly redesignated paragraph (g)(8)(ii)(A)(3) as paragraph (g)(8)(ii)(A)(4); and

13. Further redesignating newly redesignated paragraphs (g)(8)(iii)(i) through (v) as paragraphs (g)(8)(iii)(A) through (E), respectively;

14. Further redesignating newly redesignated paragraphs (g)(8)(iv)(i) through (iii) as paragraphs (g)(8)(iv)(A) through (C), respectively;

15. Further redesignating newly redesignated paragraphs (g)(8)(v)(i) through (iii) as paragraphs (g)(8)(v)(A) through (C), respectively;

16. In newly redesignated paragraph (g)(8)(v)(B), removing “(g)(4)(i)” and adding “(g)(4)(i)” in its place; and

17. Adding paragraphs (g)(8)(vi) and (g)(9).

The additions read as follows:

*§1.1031(k)-1 Treatment of deferred exchanges.*

\* \* \* \* \*

(g) \* \* \* \*

(7) \* \* \* \*

(iii) Personal property that is incidental to real property acquired in an exchange. For purposes of this paragraph (g)(7), personal property is incidental to real property acquired in an exchange if—

(A) In standard commercial transactions, the personal property is typically transferred together with the real property; and

(B) The aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15 percent of the aggregate fair market value of the replacement real property.

\* \* \* \* \*

(8) \* \* \* \*

\* \* \* \* \*

(vi) *Example 6.* (A) In 2020, B transfers to C real property with a fair market value of \$1,100,000 and an adjusted basis of \$400,000. B's replacement property is an office building and, as a part of the exchange, B also will acquire certain office furniture in the building that is not real property, which is industry practice in a transaction of this type. The fair market value of the real property B will acquire is \$1,000,000 and the fair market value of the personal property is \$100,000.

(B) In a standard commercial transaction, the buyer of an office building typically also acquires some or all of the office furniture in the building. The fair market value of the personal property B will acquire does not exceed 15 percent of the fair market value of the office building B will acquire. Accordingly, under paragraph (g)(7)(iii) of this section, the personal property is incidental to the real property in the exchange and is disregarded in de-

termining whether the taxpayer's rights to receive, pledge, borrow or otherwise obtain the benefits of money or other property are expressly limited as provided in paragraph (g)(6) of this section. Upon the receipt of the personal property, B recognizes gain of \$100,000 under section 1031(b), the lesser of the realized gain on the disposition of the relinquished property, \$700,000, and the fair market value of the non-like-kind property B acquired in the exchange, \$100,000.

(9) *Applicability date.* Paragraphs (g)(7)(iii) and (g)(8)(vi) of this section apply to exchanges beginning on or after [EFFECTIVE DATE OF THE FINAL RULE].

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Sunita Lough,  
Deputy Commissioner for Services  
and Enforcement

(Filed by the Office of the Federal Register on June 11, 2020, 8:45 a.m., and published in the issue of the Federal Register for June 12, 2020, 85 F.R. 35835)

## Notice of Proposed Rulemaking

### Consolidated Net Operating Losses

**REG-125716-18**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; partial withdrawal of a notice of proposed rulemaking.

SUMMARY: This notice of proposed rulemaking contains proposed amendments to the consolidated return regulations under section 1502 of the Internal Revenue Code (Code). The proposed regulations provide guidance implementing recent statutory amendments to section 172 and withdraw and re-propose certain sections of proposed regulations issued in prior notices of proposed rulemaking relating to the absorption of consolidated net operating loss carryovers and carrybacks. In addition, the proposed regulations update regulations applicable to consolidated groups that include both life insurance

companies and other companies to reflect statutory changes. These proposed regulations would affect corporations that file consolidated returns.

DATES: Written or electronic comments and requests for a public hearing must be received by August 31, 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](http://www.regulations.gov) (indicate IRS and REG-125716-18) 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 submitted electronically (and, to the extent practicable, any comment submitted on paper) to its public docket.

Send paper submissions to: CC:PA:LP-D:PR (REG-125716-18), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Justin O. Kellar at (202) 317-6720, Gregory J. Galvin at (202) 317-3598, or William W. Burhop at (202) 317-5363; concerning submission of comments or requests for a public hearing, Regina Johnson at (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations to permit consolidated groups that acquire new members that were members of another consolidated group to elect to waive all or part of the pre-acquisition

portion of an extended carryback period under section 172 of the Code for certain losses attributable to the acquired members. The text of those temporary regulations also serves as the text of §1.1502-21(b)(3)(ii)(C) and (D) of these proposed regulations. The proposed and temporary regulations affect corporations that file consolidated returns.

## Background

These proposed regulations revise the Income Tax Regulations (26 CFR part 1) under section 1502 of the Code. Section 1502 authorizes the Secretary of the Treasury or his delegate (Secretary) to prescribe regulations for an affiliated group of corporations that join in filing (or that are required to join in filing) a consolidated return (consolidated group) to reflect clearly the Federal income tax liability of the consolidated group and to prevent avoidance of such tax liability. See §1.1502-1(h) (defining the term “consolidated group”). For purposes of carrying out those objectives, section 1502 also permits the Secretary to prescribe rules that may be different from the provisions of chapter 1 of the Code that would apply if the corporations composing the consolidated group filed separate returns. Terms used in the consolidated return regulations generally are defined in §1.1502-1.

These proposed revisions implement certain statutory amendments made by Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). Specifically, section 13302 of the TCJA amended section 172 of the Code, relating to net operating loss (NOL) deductions, and sections 13511 through 13519 of the TCJA amended subchapter L of chapter 1 of the Code (subchapter L), relating to the taxation of insurance companies. These proposed regulations also implement further statutory amendments to section 172 of the Code made by the Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136, 134 Stat. 281 (March 27, 2020) (CARES Act). Additionally, these proposed regulations update regulations under section 1502 concerning consolidated groups that include life insurance companies and other companies (life-nonlife

groups) to implement amendments under prior tax legislation.

## I. Net Operating Loss Deductions

Prior to amendment by the TCJA, section 172(a) allowed a taxpayer to use its aggregate NOL carryovers and carrybacks to a taxable year to offset all taxable income in the taxable year, and section 172(b)(1) generally permitted taxpayers to carry back NOLs two years and carry over NOLs 20 years. The TCJA amended section 172 to provide new NOL deduction rules based on (i) the type of entity generating the NOL or using an NOL to offset income, or (ii) the character of the loss giving rise to an NOL. The CARES Act extended the carryback period for NOLs arising in a taxable year beginning after December 31, 2017, and before January 1, 2021. See part I.A of this Background. Both the TCJA and the CARES Act also made other changes to section 172 that are not pertinent to this notice of proposed rulemaking.

### A. General NOL rules

As amended by section 13302(a)(1) of the TCJA and section 2303(a)(1) of the CARES Act, section 172(a)(2) of the Code allows an NOL deduction for a taxable year beginning after December 31, 2020, in an amount equal to the sum of two factors. The first factor is the aggregate amount of NOLs arising in taxable years beginning before January 1, 2018 (pre-2018 NOLs), that are carried to such taxable year. The second factor is the lesser of (i) the aggregate amount of NOLs arising in taxable years beginning after December 31, 2017 (post-2017 NOLs), that are carried to such taxable year, or (ii) 80 percent of the excess (if any) of (I) taxable income computed without regard to any deductions under sections 172, 199A, and 250 of the Code, over (II) the aggregate amount of pre-2018 NOLs carried to the taxable year (this latter calculation, the 80-percent limitation). The 80-percent limitation does not apply to taxable years beginning before January 1, 2021. See section 172(a)(1). For any such taxable year, section 172(a)(1) allows an NOL deduction equal to the aggregate amount of NOL carryovers and carrybacks to such

year. See *id.* Moreover, the 80-percent limitation does not apply to limit the use of pre-2018 NOLs. See section 172(a)(2)(A).

Section 13302(b) of the TCJA amended section 172(b) to generally eliminate NOL carrybacks but permit post-2017 NOLs to be carried over indefinitely. Section 2303(b) of the CARES Act further amended section 172(b) to require (unless waived under section 172(b)(3)) a five-year carryback for NOLs arising in taxable years beginning after December 31, 2017, and before January 1, 2021. See section 172(b)(1)(D)(i).

### B. Special NOL rules for nonlife insurance companies

Section 13302(d) of the TCJA added sections 172(b)(1)(C) and 172(f), which provide special rules for insurance companies other than life insurance companies, as defined in section 816(a) (nonlife insurance companies, which commonly are referred to as property and casualty insurance companies or P&C companies). Under section 172(f), the 80-percent limitation does not apply to nonlife insurance companies. Therefore, taxable income of nonlife insurance companies may be fully offset by NOL deductions. In addition, under sections 172(b)(1)(C) and (b)(1)(D)(i), losses of nonlife insurance companies arising in taxable years beginning after December 31, 2020, may be carried back two years and carried over 20 years. (As noted in part I.A of this Background, losses arising in taxable years beginning after December 31, 2017, and before January 1, 2021, are carried back five years.) Thus, for taxable years beginning after December 31, 2020, the operative rules under section 172 effectively apply to nonlife insurance companies in the same manner as those rules applied prior to enactment of the TCJA.

### C. Special NOL rules for farming losses

Section 13302(c) of the TCJA amended the special rules for farming losses set forth in sections 172(b)(1)(F) and 172(h), as in effect prior to enactment of the TCJA. For purposes of section 172, a “farming loss” is the lesser of (i) the amount that would be the NOL for the taxable year

if only income and deductions attributable to farming businesses (as defined in section 263A(e)(4) of the Code) were taken into account, or (ii) the amount of the NOL for that taxable year. See section 172(b)(1)(B)(ii). Under sections 172(b)(1)(B)(i) and (b)(1)(D)(i)(II), any portion of an NOL for a taxable year beginning after December 31, 2020, that is characterized as a farming loss is treated as an NOL that is carried back two years and, as provided in section 172(b)(1)(A)(ii)(II), is carried over indefinitely. Farming losses arising in taxable years beginning after December 31, 2017, and before January 1, 2021, are carried back five years. Section 172(b)(1)(D)(i).

## II. Insurance Company Provisions

The TCJA also made several changes to subchapter L (which addresses the taxation of insurance companies) that are relevant to this notice of proposed rulemaking. First, sections 13511(a) and 13511(b) of the TCJA (i) struck section 805(b)(4), which generally denied life insurance companies the NOL deduction provided in section 172, and (ii) made a conforming amendment by striking section 810, which provided a deduction for operations losses for life insurance companies. As a result, effective for taxable years beginning after December 31, 2017, life insurance companies are entitled to an NOL deduction under the general rules of section 172. Second, section 13001(b)(2)(A) of the TCJA struck section 1201, which imposed a minimum tax on capital gains. Third, section 13514(a) of the TCJA struck section 815, which provided continued deferral of tax on policyholders surplus accounts. Fourth, under section 13514(d) of the TCJA, stock life insurance companies must pay the tax imposed by section 801 on the balance of any policyholders surplus accounts (determined as of the close of such company’s last taxable year beginning before January 1, 2018) ratably over the first eight taxable years beginning after December 31, 2017.

Additionally, section 2303(b) of the CARES Act added a special rule for life insurance companies. Section 172(b)(1)(D)(iii) provides that, in the case of a life insurance company, if an NOL is carried back under section 172(b)(1)(D)(i)(I) to a life insurance company taxable year be-

ginning before January 1, 2018, such NOL carryback shall be treated in the same manner as an operations loss carryback (within the meaning of section 810 as in effect before its repeal) of such company to such taxable year.

Because the repeal of section 810 is effective for losses arising in taxable years beginning after December 31, 2017, operations loss carryovers from taxable years beginning before January 1, 2018, continue to be allowed as deductions in taxable years beginning after December 31, 2017, in accordance with section 810 as in effect before its repeal by the TCJA. See Staff of the Joint Comm. on Tax'n, 115th Cong., General Explanation of Public Law 115-97, at 226 (Dec. 2018).

Final regulations applicable to life-non-life groups under §1.1502-47 were published in the **Federal Register** on March 18, 1983. See 48 FR 11441 (March 18, 1983) (current life-nonlife regulations). In the years that followed that publication, other legislation also significantly altered the taxation of insurance companies.

## Explanation of Provisions

### I. Overview

These proposed regulations provide guidance for consolidated groups regarding the application of the 80-percent limitation, as originally enacted as part of the TCJA and subsequently amended by the CARES Act. These proposed regulations also provide guidance regarding the application of the NOL carryback provisions following enactment of the TCJA and the CARES Act. In addition, the proposed regulations withdraw and re-propose certain sections of proposed regulations issued under section 1502 in prior notices of proposed rulemaking that relate to the absorption of NOL carrybacks and carryovers. See part II of this Explanation of Provisions for a further discussion.

These proposed regulations also update §1.1502-47 to reflect certain changes to the insurance company rules made by the CARES Act, the TCJA, and prior tax legislation. See part III of this Explanation of Provisions for a further discussion. The Treasury Department and the IRS continue to study other issues pertinent to

life-nonlife groups for purposes of potential future guidance.

### II. Amendments to §1.1502-21

#### A. In general

Under section 172, as amended by the TCJA and the CARES Act, NOLs generated by certain members of a consolidated group (that is, nonlife insurance companies), as well as NOLs generated by certain business activity within a consolidated group (that is, farming losses), are subject to different rules than other NOLs in taxable years beginning after December 31, 2020. The proposed regulations implement these statutory rules with regard to affiliated groups of corporations that file consolidated returns.

#### B. Application of the 80-percent limitation

##### 1. In General

Section 1.1502-21(a) defines the consolidated net operating loss (CNOL) deduction for any consolidated return year as “the aggregate of the net operating loss carryovers and carrybacks to the year.” This section specifies that “[t]he net operating loss carryovers and carrybacks consist of (1) [a]ny CNOLs . . . of the consolidated group; and (2) [a]ny net operating losses of the members arising in separate return years.” NOL carryovers and carrybacks to a consolidated return year are determined under the principles of section 172 and §1.1502-21. See §1.1502-21(b)(1). For example, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose. See *id.*

As discussed in part I.A of the Background, the 80-percent limitation on the use of post-2017 NOLs to offset taxable income (other than taxable income of nonlife insurance companies) applies to taxable years beginning after December 31, 2020. Consistent with longstanding provisions in §1.1502-21(b)(1), these proposed regulations generally implement the 80-percent limitation on a consolidated group basis by limiting a group’s deduction of post-2017 NOLs for any such taxable year to the lesser of (1) the

aggregate amount of post-2017 NOLs carried to such year, or (2) 80 percent of the excess (if any) of the group’s consolidated taxable income (CTI) (computed without regard to any deductions under sections 172, 199A, and 250) over the aggregate amount of pre-2018 NOLs carried to such year. Thus, the amount allowed as a deduction for a particular consolidated return year beginning after December 31, 2020, equals the sum of (1) pre-2018 NOLs carried to that year (see section 172(a)(2)(A)), and (2) post-2017 NOLs carried to that year after applying the 80-percent limitation (see section 172(a)(2)(B)). Additionally, the proposed regulations provide special rules applicable to consolidated groups that include at least one nonlife insurance company, as well as rules applicable to losses arising in a separate return limitation year (SRLY).

#### 2. Application of the 80-Percent Limitation to Groups Comprised of Nonlife Insurance Companies, Members Other than Nonlife Insurance Companies, or Both

Application of the 80-percent limitation depends on the status of the entity whose income is being offset, rather than on the status of the entity whose loss is being absorbed. As noted in part I.B of the Background, section 172(f) provides that the 80-percent limitation does not apply when the taxable income of a nonlife insurance company is offset by an NOL carryback or carryover.

To implement the special rules under section 172 regarding income of nonlife insurance companies, these proposed regulations clarify that application of the 80-percent limitation within a consolidated group to post-2017 NOLs (post-2017 CNOL deduction limit) depends on the status of the entity that generated the income being offset in a consolidated return year beginning after December 31, 2020. Therefore, if a group is comprised solely of members other than nonlife insurance companies during a consolidated return year beginning after December 31, 2020, the post-2017 CNOL deduction limit for the group for that year is determined by applying the 80-percent limitation to all of the group’s consolidated taxable income for that year. In contrast, if a group

is comprised solely of nonlife insurance companies during a consolidated return year beginning after December 31, 2020, the post-2017 CNOL deduction limit for the group for that year simply equals the group's CTI less the aggregate amount of pre-2018 NOLs carried to that year.

A two-factor computation is required if a consolidated group is comprised of both nonlife insurance companies and other members in a consolidated return year beginning after December 31, 2020. In general, under these proposed regulations, the post-2017 CNOL deduction limit for the group would equal the sum of two amounts.

The first amount relates to the income of those members that are not nonlife insurance companies (residual income pool). This amount equals the lesser of (i) the aggregate amount of post-2017 NOLs carried to that year, or (ii) 80 percent of the excess of the group's CTI for that year (determined without regard to income, gain, deduction, or loss of members that are nonlife insurance companies and without regard to any deductions under sections 172, 199A, and 250) over the aggregate amount of pre-2018 NOLs carried to that year that are allocated to the positive net income of members other than nonlife insurance companies.

The second amount relates to the income of those members that are nonlife insurance companies (nonlife income pool). This amount equals 100 percent of the group's CTI for the year (determined without regard to any income, gain, deduction, or loss of members that are not nonlife insurance companies), less the aggregate amount of pre-2018 NOLs carried to that year that are allocated to the positive net income of nonlife insurance company members.

For purposes of computing the foregoing amounts, pre-2018 NOLs are allocated pro rata between the two types of income pools in the group (that is, the income pool for nonlife insurance companies and the income pool for all other members, respectively). This allocation is based on the relative amounts of positive net income in each pool in the particular consolidated return year.

For example, assume that P, PC1, and PC2 are members of a calendar-year consolidated group (P Group). PC1 and

PC2 are nonlife insurance companies, and P is a holding company. In 2017, the P Group has a CNOL of \$10 (that is, a pre-2018 NOL). In 2021, P has income of \$50, PC1 has income of \$70, and PC2 has a loss of \$20. Therefore, the P Group has \$100 of CTI in 2021. In 2022, the P Group has a \$100 CNOL (all of which is attributable to PC1 and PC2) that is carried back to 2021. Under sections 172(a)(2)(B) and 172(f), the P Group's 2022 CNOL would offset P's 2021 income subject to the 80-percent limitation, but it would offset PC1's 2021 income without limitation.

The total amount allowed as a CNOL deduction in the P Group's 2021 consolidated return year equals the aggregate amount of pre-2018 NOLs carried to that year plus the P Group's post-2017 CNOL deduction limit for that year. The P Group has \$10 of pre-2018 NOLs carried to 2021. Under section 172(a)(2)(A) and §1.1502-21(b)(1), this loss would offset \$10 of the P Group's 2021 income.

Under these proposed regulations, the P Group's post-2017 CNOL deduction limit for its 2021 consolidated return year is equal to the sum of the following two amounts. The first amount reflects the application of the 80-percent limitation to P's income (that is, the residual income pool). This amount is \$36, which equals the lesser of (i) the aggregate amount of the P Group's post-2017 NOLs carried to its 2021 consolidated return year (\$100), or (ii) the product obtained by multiplying 80 percent by \$45 (the excess of \$50 (P's 2021 income) over \$5 (the pro rata amount of pre-2018 NOLs allocated to P's income)).

The second amount reflects the application of section 172(f) to the income of PC1 and PC2 (that is, the nonlife income pool). This amount is \$45, which is obtained by subtracting \$5 (the pro rata amount of pre-2018 NOLs allocated to the income of PC1 and PC2) from \$50 (PC1's 2021 income of \$70 - PC2's 2021 loss of \$20).

Thus, the P Group has a CNOL deduction of \$91 for 2021, which includes (1) the aggregate amount of pre-2018 NOLs carried to 2021 (\$10), plus (2) the P Group's post-2017 deduction limit (\$36 + \$45 = \$81). The P Group has \$9 of CTI in 2021 and carries over the remaining \$19

of its 2022 CNOL (\$100 - \$81) to future taxable years.

If a group's nonlife insurance company members have net income for a particular consolidated return year beginning after December 31, 2020, and its other members have a net loss for that year (or vice-versa), these proposed regulations modify the foregoing computation to ensure that the group's post-2017 CNOL deduction limit for that year is not overstated. If the group's nonlife insurance company members have a loss for the consolidated return year and its other members have income for that year, the group's post-2017 CNOL deduction limit equals the lesser of (i) the aggregate amount of post-2017 CNOLs carried to the year, or (ii) 80 percent of the excess of the group's CTI (determined without regard to any deductions under sections 172, 199A, and 250) over the aggregate amount of pre-2018 NOLs carried to that year. That is, because none of the group's net income has been produced by the group's P&C insurance operations, the 80-percent limitation will apply to all CTI for the year. Conversely, if the group's nonlife insurance company members have income for the consolidated return year and its other members have a loss for that year, the group's post-2017 CNOL deduction limit equals the group's CTI less the aggregate amount of pre-2018 NOLs carried to that year. That is, because all net income of the group has been produced by the operation of members that are nonlife insurance companies (whose income is not subject to the 80-percent limitation), all CTI for the year may be offset by post-2017 CNOL deductions.

In formulating these proposed regulations, the Treasury Department and the IRS considered an alternative approach. Following the enactment of the TCJA and the CARES Act, section 172 provides special rules applicable to entities of different tax status, both with regard to the use of NOLs to offset income and with regard to the manner in which NOLs are carried over. This alternative approach would have required a group to first offset income and loss items within a pool of nonlife insurance companies and a pool of other members for all purposes of section 172 applicable to taxable years beginning after December 31, 2020. In other words, the alternative approach would have applied a pooling concept beyond merely determining the group's post-

2017 CNOL deduction limit, but would have required a group's CTI to be allocated between the operations of its nonlife insurance company members, which can be offset fully by CNOL deductions, and the operations of its other members subject to the 80-percent limitation. This alternative approach would also have applied similar rules to allocate CNOLs within groups including both nonlife insurance companies and other members to consistently identify the portions of CNOLs allocable to nonlife insurance company members, which are subject to different carryover rules than those of other members.

Specifically, this alternative approach would have adopted a threshold computational step under which the principles of §1.1502-21(b)(2)(iv)(B) would apply to offset the income and loss items solely among members that are nonlife insurance companies. The remaining members of the group would be subject to a parallel offset. Following this initial offsetting of pooled items, §1.1502-21(b)(2)(iv)(B) (or the principles of §1.1502-21(b)(2)(iv)(B), in the case of a group with CTI) would apply to allocate a post-2017 CNOL among all group members with taxable income. This approach contrasts with the historical application of §1.1502-21(b)(2)(iv)(B), under which a CNOL for a year is attributed pro rata to all members of a group that produce net loss, without first netting among entities of the same type. This historical approach developed before the enactment of the TCJA, and thus before special carryover rules applied to nonlife insurance companies.

The Treasury Department and the IRS request comments regarding the proposed regulations' methodology for computing a group's post-2017 CNOL deduction limit. The Treasury Department and the IRS also request comments regarding the alternative approach described in the preceding two paragraphs to identify the portion of the CNOL to which the special carryback and carryover rules of section 172(b) (regarding nonlife insurance company losses) would apply.

### 3. Losses Arising in a SRLY

Generally, an unaffiliated corporation determines its taxable income by offsetting its NOLs against its income. In con-

trast, a consolidated group member generally offsets its NOLs against the income of all group members. See §§1.1502-11 and 1.1502-21. However, an exception to this general rule for consolidated groups applies to a group's use of NOLs incurred by a member (SRLY member) in a taxable year other than a year of the current group (that is, a separate return limitation year or SRLY). A SRLY member may carry its NOLs that arose in a SRLY into the consolidated group, but those NOLs can be absorbed by the group only to the extent that the SRLY member generates income on a separate-entity basis while a member of the group (that is, to the extent of the amount of net income generated by the SRLY member as a member of the group). See generally §1.1502-21(c)(1)(i) (setting forth the general SRLY limitation rule).

The SRLY rules attempt to replicate, to the extent possible, separate-entity usage of the SRLY attributes of the SRLY member. In other words, the SRLY regulations were designed to obtain an absorption result that varies as little as possible from the absorption that would have occurred if the SRLY member had not joined the consolidated group.

To approximate a SRLY member's absorption of NOLs on a separate-entity basis, the SRLY member's net contribution to the CTI of the group is measured cumulatively over the period during which the corporation is a member of the group by using what is commonly referred to as a "cumulative register." The cumulative register tracks the SRLY member's net positive (or negative) contribution to the income of the group. See §1.1502-21(c)(1)(i). If the SRLY member has net positive income in a consolidated taxable year, the member's cumulative register increases. See §1.1502-21(c)(1)(i)(A) and (C). In turn, if the losses of a SRLY member (including SRLY-limited NOL carryovers) are absorbed by the group, the SRLY member's cumulative register decreases. See §1.1502-21(c)(1)(i)(B) and (C).

These proposed regulations would modify the cumulative register rules to reflect the application of the 80-percent limitation under section 172(a)(2)(B). Under the proposed regulations, as in current §1.1502-21, the full amount of the SRLY member's current-year income (or current-year absorbed loss) increases (or

decreases) the member's cumulative register. However, when the cumulative register is reduced to account for the group's absorption of any SRLY member's NOLs that are subject to the 80-percent limitation (whether or not those losses are subject to the SRLY limitation), the amount of the reduction equals the full amount of income that would be necessary to support the deduction by the SRLY member.

For example, after absorption of any pre-2018 NOLs of a SRLY member, the SRLY member (other than a nonlife insurance company) would need to have \$100 of remaining income to enable the group to absorb \$80 of the SRLY member's SRLY-limited post-2017 NOLs in a taxable year beginning after December 31, 2020 (that is, 80 percent of the excess of \$100 over \$0). Therefore, upon the group's deduction of \$80 of NOL (SRLY or otherwise) of the SRLY member, the cumulative register would be reduced to reflect the full \$100 of income, not just the \$80 of losses absorbed by the group.

The Treasury Department and the IRS have determined that, without the adjustment described, the SRLY member would achieve a different result as a member of a group than as a stand-alone entity. Such result would be contrary to the objective of the SRLY rules, which attempt to replicate the hypothetical separate-entity treatment of the SRLY member. Therefore, the above-described adjustment would be necessary to ensure that the SRLY member achieves the same Federal income tax result as if the SRLY member continued to be a stand-alone entity.

For example, assume that P owns 79 percent of S, and that neither P nor S is a nonlife insurance company. In Year 1 (a taxable year beginning after December 31, 2020), S incurs an \$800 NOL that it carries over into Year 2. S has no other NOL carryovers or carrybacks. In Year 2, S has \$400 of income; accordingly, S's 80-percent limitation for Year 2 is \$320 (that is, the lesser of \$800 or 80 percent of the excess of \$400 over \$0). As a result, S may use \$320 of its \$800 Year 1 NOL to offset \$320 of its \$400 Year 2 income. Under section 172(b)(2), the amount of the \$800 Year 1 NOL that is carried into Year 3 is the excess of the entire \$800 NOL over \$320, or \$480. S's ability to use any portion of its remaining Year 1 NOL in Year 3

is dependent on its generation of additional taxable income in Year 3.

Now assume that, instead of S filing a separate return for Year 2, P acquires the remaining stock of S at the end of Year 1, and P and S file a consolidated return for Year 2. The P group has \$1,000 of income in Year 2, of which S has \$400. Thus, S's cumulative register increases from \$0 to \$400. Because S's \$800 Year 1 NOL arose in a SRLY, the absorption of this NOL in Year 2 is subject to both the SRLY limitation and the 80-percent limitation. Under the proposed regulations, the P group may use only \$320 (that is, the lesser of \$800 or 80 percent of the excess of \$400 over \$0) of S's Year 1 SRLY NOL to offset the P group's Year 2 income. Upon the absorption of \$320 of S's Year 1 SRLY NOL, S's cumulative register is reduced by \$400 (that is, the full amount of income necessary to support the \$320 deduction of S's Year 1 SRLY NOL) to \$0. The remainder of S's Year 1 SRLY NOL is carried over.

If S's cumulative register were not reduced by the full amount of income necessary to support the deduction, the P group's ability to use S's loss would exceed S's ability to use the loss if S had not joined the P group. As an illustration, assume further that, in Year 3, the P group has \$200 of income, with no net amount of income or loss attributable to S. Because S's cumulative register would remain at \$0, the P group would not be able to offset any of its \$200 Year 3 income with S's Year 1 SRLY NOL. If S's cumulative register were reduced solely by the amount of the SRLY NOL deducted in Year 2 (\$320), S would have \$80 remaining in its cumulative register (\$400 - \$320), and the P group could absorb an additional \$64 (that is, the lesser of \$480 or 80 percent of the excess of \$80 over \$0) of S's remaining Year 1 SRLY NOL in Year 3. In contrast, if S had not joined the P group and had not generated any income in Year 3, it would not have been able to use any of its \$480 remaining Year 1 SRLY NOL in Year 3. In other words, S would have been able to use a total of only \$320 of its Year 1 SRLY NOL in Years 2 and 3.

Therefore, absent an adjustment to S's cumulative register to account for the 80-percent limitation, S would achieve a different result as a member of a consolidated group than if S had remained a

stand-alone entity. As explained earlier in this part II.B.3 of this Explanation of Provisions, such a result would be inconsistent with the purpose of the SRLY regime. See the preamble to TD 8823 published in the **Federal Register** July 2, 1999 (64 FR 36092).

#### C. Recomputation of amount of CNOL attributable to each member

Section 1.1502-21(b)(2)(i) generally provides that, if a group has a CNOL that is carried to another taxable year, the CNOL is apportioned among the group's members. For this purpose, §1.1502-21(b)(2)(iv) provides a fraction, the numerator of which is the separate NOL of each member for the consolidated return year of the loss (determined by taking into account only the member's items of income, gain, deduction, and loss), and the denominator of which is the sum of the separate NOLs of all members for that year.

If a member's portion of a CNOL is absorbed or reduced on a non-pro rata basis, the percentage of the CNOL attributable to each member must be recomputed to reflect the proper allocation of the remaining CNOL. For instance, if a portion of a CNOL allocable to a nonlife insurance company is carried back to and absorbed in a prior taxable year under the special rule for nonlife insurance companies that applies for taxable years beginning after December 31, 2020 (see part I.B of the Background), all or some portion of the CNOL allocable to the nonlife insurance company is reduced even though the portion of the CNOL allocable to other members remains untouched. Therefore, the allocation of the remaining CNOL must be recomputed.

Accordingly, these proposed regulations provide that, if a member's portion of a CNOL is absorbed or reduced on a non-pro rata basis, the percentage of the CNOL attributable to each member is recomputed. The recomputed percentage of the CNOL attributable to each member equals the remaining CNOL attributable to the member at the time of the recomputation, divided by the sum of the remaining CNOL attributable to all of the remaining members at the time of the recomputation. In other words, if at the time of the recomputation a member's attributable portion

of the group's remaining CNOL equals \$20, and the sum of the remaining CNOL attributable to all of the group's remaining members equals \$80, the recomputed percentage of the CNOL attributable to the member would equal 25 percent.

Proposed regulations (REG-101652-10) published in the **Federal Register** (80 FR 33211) on June 11, 2015 (2015 proposed regulations) contained a similar rule (see §1.1502-21(b)(2)(iv)(B)(2) of the 2015 proposed regulations). These proposed regulations withdraw proposed §1.1502-21(b)(2)(iv)(B)(2) of the 2015 proposed regulations and re-propose substantially similar language in new proposed §1.1502-21(b)(2)(iv)(B)(2).

#### D. Farming losses

For a taxable year beginning after December 31, 2020, section 172(b)(1)(B) permits the portion of a taxpayer's NOL for the taxable year that is a farming loss to be carried back two years. Under that provision, the term "farming loss" means the lesser of the amount that would be the NOL if only the income and deductions attributable to farming businesses (as defined in section 263A(e)(4)) were taken into account, or the amount of a taxpayer's NOL for the year.

Whereas the special nonlife insurance company rules in section 172 apply based on the status of the entity that generated the loss, the special farming loss carryback rules in section 172 apply based on the character of the loss; that is, whether the loss resulted from farming activity. The special rule for farming losses creates a situation similar to that addressed in *United Dominion Industries, Inc. v. United States*, 532 U.S. 822 (2001), which involved the calculation within a consolidated group of a product liability loss (PLL). A PLL was a "special status loss" that was subject to a 10-year carryback period and that was equal to the aggregate of all members' product liability expenses (PLEs), limited by the NOL for the year. A consolidated group generally is treated as having a single, unitary CNOL for a taxable year (based on all items of income and loss in the group) that is allocated among members only for specified purposes, including carrybacks and carryovers to other taxable years. See §1.1502-21(e) (de-

fining the term “CNOL”); §1.1502-11(a) (setting forth the general computation for determining CTI). Because the regulations under section 1502 did not allocate the CNOL for purposes of calculating the limitation on PLL, the Supreme Court held that the amount of a group’s PLL was limited by the entire amount of the group’s CNOL.

In a notice of proposed rulemaking (REG-140668-07) published in the **Federal Register** (77 FR 57452) on September 17, 2012 (2012 proposed regulations), the Treasury Department and the IRS provided rules regarding the apportionment of CNOLs that contain a component portion of a special status loss, such as a corporate equity reduction interest loss or a specified liability loss. Such losses, like farming losses and the PLLs that were considered in *United Dominion*, were subject to special carryback rules. The 2012 proposed regulations effectuated the holding in *United Dominion* that a group’s CNOL, which is the limit on the amount of a group’s special status losses, may be generated anywhere in the group. See 77 FR 57452, 57458. On that basis, the 2012 proposed regulations apportioned such special status losses to each group member that generated a loss in the year in which the special status loss was incurred, regardless of whether any specific member had undertaken the activities that generated the expenses that effectively were granted special status. See *id.*

Consistent with the 2012 proposed regulations, these proposed regulations re-propose, in modified form, a specific rule regarding the apportionment of CNOLs that include farming losses arising in taxable years beginning after December 31, 2020, or other special status losses. See proposed §1.1502-21(b)(2)(iv)(D). (Due to the TCJA’s removal of the corporate equity reduction interest loss provisions in former section 172(g), proposed §1.1502-21(b)(2)(iv)(D) does not contain explicit rules governing such losses.) Under proposed §1.1502-21(b)(2)(iv)(D), the portion of the CNOL constituting a special status loss is apportioned to each group member separately from the remainder of the CNOL under the method provided in §1.1502-21(b)(2)(iv). Consistent with the 2012 proposed regulations, this apportionment occurs without

separate inquiry into whether a particular member actually incurred the special status loss. See 77 FR 57452, 57458. These proposed regulations withdraw §1.1502-21(b)(2)(iv)(C), as proposed in the 2012 proposed regulations. The Treasury Department and the IRS request comments regarding this approach.

*E. Elections to waive portions of the five-year carryback period under section 172(b)(1)(D)(i)*

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** add new paragraphs (b)(3)(ii)(C) and (D) to the regulations in §1.1502-21. The temporary regulations provide rules to permit consolidated groups that acquire new members that were members of another consolidated group to elect to waive all or part of the pre-acquisition portion of an extended carryback period under section 172 for certain losses attributable to the acquired members. The text of those regulations also serves as the text of §1.1502-21(b)(3)(ii)(C) and (D) of these proposed regulations. The preamble to the temporary regulations explains the amendments.

### **III. Amendments to §1.1502-47**

#### *A. Overview*

##### *1. Legislative Background at the Time the Current Life-Nonlife Regulations Were Promulgated*

The Life Insurance Company Income Tax Act of 1959, Public Law 86-69, 73 Stat. 112 (June 25, 1959), established a three-phase system of taxation for life insurance companies (also referred to as life companies). Under the first phase of this three-phase system (phase 1), a life company was taxed on the lesser of its taxable investment income (TII) or its gain from operations (GO). If a company’s GO exceeded its TII, the company was taxed on 50 percent of such excess (phase 2). The other half of the GO in excess of TII was added, along with certain other items, to the policyholders surplus account, which was taxed when distributed to shareholders of a stock company (phase 3). Life companies also were permitted certain

deductions that were unique to insurance companies, such as increases in reserves to the extent not funded out of the policyholders’ share of investment income.

Prior to the enactment of the Tax Reform Act of 1976, Public Law 94-455, 90 Stat. 1520 (October 4, 1976) (1976 Act), life companies were prohibited from filing consolidated returns with nonlife companies, including both nonlife insurance companies and other types of corporations. This prohibition resulted in part from historical differences between the taxation of life companies and nonlife companies.

Section 1507 of the 1976 Act (90 Stat. 1520, 1739-41) permitted life companies to consolidate with nonlife companies, subject to additional restrictions that do not apply to a regular consolidated group. Section 1503(c)(1) (as amended by the 1976 Act and subsequent tax legislation) provides that, if the nonlife company members of a life-nonlife group (nonlife members) have a loss for the taxable year, then under regulations to be issued by the Secretary, the amount of the loss that cannot be carried back and absorbed by the taxable income of the nonlife members can be taken into account in determining the CTI of the group only to the extent of the lesser of 35 percent of such loss or 35 percent of the taxable income of the life company members of the group (life members). Further, section 1503(c)(2) (as so amended) provides that the losses of a recent nonlife affiliate may not be used by a life company before the sixth taxable year the companies have been members of the same affiliated group.

##### *2. Current Life-Nonlife Regulations*

The current life-nonlife regulations adopted a subgroup method for computing a life-nonlife group’s CTI. Under the subgroup method, the nonlife members and the life members generally are treated as if the members compose two separate consolidated groups, with certain exceptions (including intercompany transactions, as defined in §1.1502-13(b)(1)(i)). Thus, each of the life subgroup and the nonlife subgroup separately calculates its taxable income. Subgroup losses that are eligible to be carried back must be carried back to offset subgroup income in prior taxable

years before being used to offset income of the other subgroup in the current taxable year, and subgroup losses may not be carried back to offset income of the other subgroup in prior taxable years.

Further, a carryback of a subgroup loss may “bump” the loss of the other subgroup used in the carryback year (that is, the loss that is carried back may supplant a loss of the other subgroup in the carryback year). See §1.1502-47(a)(2)(ii). For example, assume that life subgroup losses were used to offset nonlife subgroup income in Year 1. If the nonlife subgroup incurs losses in Year 2 that are eligible to be carried back to Year 1, those Year 2 nonlife subgroup losses (rather than the Year 1 life subgroup losses) would be used to offset the nonlife subgroup’s income in Year 1. The “bumped” life subgroup losses from Year 1 then would be carried over to future taxable years.

### 3. Legislative Changes Regarding the Taxation of Insurance Companies Since Promulgation of the Current Life-Nonlife Regulations

The Deficit Reduction Act of 1984, Public Law 98-369, 98 Stat. 494 (July 18, 1984) (1984 Act), significantly altered the taxation of life companies. The 1984 Act replaced the three-phase system with a statutory mechanism similar to that used to calculate the Federal income tax liability of other corporate taxpayers. Specifically, section 801(a) imposes an income tax on the life insurance company taxable income (LICTI) of a life company, and section 801(b) defines “life insurance company taxable income” as life insurance gross income less life insurance deductions. The legislative history of the 1984 Act indicates that, in part, Congress changed the taxation of life companies in order to simplify the Code. See Staff of the Joint Comm. on Tax’n, 98th Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 577 (December 31, 1984).

In turn, the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2085 (October 22, 1986) (1986 Act), modified the taxation of nonlife insurance companies. Prior to the 1986 Act, nonlife insurance companies were permitted to defer unearned premium income while currently

deducting the expenses associated with earning such income, which created a timing mismatch between the income and expenses of nonlife insurance companies. The 1986 Act addressed this mismatch by requiring a nonlife insurance company to reduce its deduction for unearned premium income by 20 percent. The 1986 Act also repealed special rates, deductions, and exemptions for small mutual insurance companies and added a single provision (section 831(b)) for both small mutual insurance companies and small stock insurance companies.

Lastly, the TCJA made significant additional changes to the taxation of life insurance companies, and the CARES Act added a special rule for such companies in section 172(b)(1)(D)(iii). These changes are described in detail in part II of the Background.

#### B. Summary of proposed changes to §1.1502-47

As a result of changes in the taxation of insurance companies under the TCJA and prior legislation, various provisions in §1.1502-47 currently are outdated. Accordingly, to the extent preempted by statute, the current regulations have no application. These proposed regulations update §1.1502-47 by: (1) removing paragraphs implementing statutory provisions that have been repealed; (2) revising paragraphs implementing statutory provisions that have been substantially revised; (3) updating terminology and statutory references to account for other statutory changes; and (4) removing paragraphs that contain obsolete transition rules or that are no longer applicable because the effective dates in the current life-nonlife regulations have passed.

#### 1. Removal of Paragraphs Due to Repealed Statutory Provisions

Certain paragraphs in §1.1502-47 are no longer relevant to the calculation of life-nonlife CTI because of the repeal of the three-phase system by the 1984 Act and later amendments to the Code. Therefore, these proposed regulations remove numerous paragraphs including current §§1.1502-47(k) and (l), which provide rules for calculating consolidat-

ed TII and the consolidated GO or loss from operations (LO). These proposed regulations also remove (i) §1.1502-47(f)(7)(ii), which generally provides that the consolidated tax liability of a life-nonlife group includes the tax described by section 1201, and (ii) §1.1502-47(o), which provides rules for calculating the alternative tax imposed by section 1201 on consolidated capital gain. (As noted in part II of the Background, section 1201 was repealed by the TCJA.)

#### 2. Updates Reflecting Substantially Revised Statutory Provisions

These proposed regulations also update §1.1502-47 to reflect changes to certain statutory provisions since the current life-nonlife regulations were promulgated. For example, these proposed regulations modify current §1.1502-47(f)(5) (relating to the dividends received deduction) to reflect changes by the 1986 Act to sections 805(a)(4) and 818(e)(2) (for life companies) and to reflect changes by the 1986 Act and the Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647, 102 Stat. 3342 (November 10, 1988), respectively, to sections 832(b)(5)(B) and (g) (for nonlife insurance companies). Under modified §1.1502-47(f)(5) (that is, proposed §1.1502-47(d)(5)), dividends received by an insurance company from another includible member of the group are treated as if the group were not filing a consolidated return. To reflect the repeal of section 815 by the TCJA, these proposed regulations also remove current §1.1502-47(g)(3) (which provides that life-nonlife groups must include any amounts subtracted under section 815 from life members’ policyholders surplus accounts).

Additionally, these proposed regulations update the rules relating to consolidated LICTI to reflect the repeal of the three-phase system by the 1984 Act and other changes to the taxation of life companies. These proposed regulations also move certain provisions in current §1.1502-47(k) (consolidated TII) and (l) (consolidated GO or LO) that remain applicable following the repeal of the three-phase system to revised paragraph (g), and they implement the special rule for life insurance companies in section 172(b)(1)(D)(iii) under the CARES Act.

### 3. Revisions to Account for Other Statutory Changes

These proposed regulations also update terminology and citations to the Code to reflect current law. For example, these proposed regulations remove references to section 821 and mutual insurance companies because the statutory provisions regarding mutual insurance companies were repealed by the 1986 Act. Additionally, these proposed regulations replace references to section 802 with references to section 801 because section 802 was repealed by the 1984 Act. Similarly, these proposed regulations replace references to the LO with references to the NOL deduction under section 172 to reflect the repeal of section 810 by the TCJA.

### 4. Removal of Obsolete Transition Rules and Other Rules that no Longer are Applicable

These proposed regulations propose the removal of transition rules regarding the implementation of the current life-nonlife regulations, since those transition rules apply to carryovers that either have been absorbed or have expired. For example, the proposed regulations propose the removal of current §1.1502-47(h)(3) (setting forth transition rules for NOLs attributable to taxable years ending before January 1, 1981), current §1.1502-47(k)(6) (containing a similar rule for certain capital loss carryovers), and current §1.1502-47(e)(4) (granting certain life-nonlife groups permission to discontinue filing a consolidated return for the group's first taxable year for which the current life-nonlife regulations were effective).

These proposed regulations also would remove cross-references to certain prior-law regulations that are designated with an "A" because those regulations generally are applicable to years ending in 1999 or earlier. Additionally, these proposed regulations would remove cross-references to §1.1502-18 (relating to inventory adjustments) because that section does not apply to taxable years beginning after July 11, 1995.

### Proposed Effective/Applicability Dates

The regulations in proposed §1.1502-21 generally are proposed to be applicable

to losses arising in taxable years beginning after the date of publication in the **Federal Register** of a Treasury decision adopting these proposed rules as final regulations (Publication Date). The regulations in proposed §§1.1502-1 and 1.1502-47 generally are proposed to be applicable to taxable years beginning after the Publication Date. However, a taxpayer deducting post-2017 NOLs on (1) original returns, (2) amended returns, or (3) applications for tentative carryback adjustments, filed for taxable years beginning on or before the Publication Date, may rely on these proposed regulations concerning the Federal income tax treatment of post-2017 NOLs with regard to those filings if the taxpayer relies on the proposed regulations in their entirety and in a consistent manner.

### Special Analyses

#### I. Regulatory Planning and Review – Economic Analysis

Executive Orders 13563, 13771, and 12866 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.

These 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 the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs has designated the proposed regulations as significant under section 1(b) of the Memorandum of Agreement. Accordingly, OMB has reviewed the proposed regulations.

##### A. Background and Need for Regulations

In general, taxpayers whose deductions exceed their income generate a net operating loss (NOL), calculated under the rules of section 172. Section 172 also

governs the use of NOLs generated in other years to offset taxable income in the current year. Regulations issued under the authority of section 1502 may be used to govern how section 172 applies to consolidated groups of C corporations. In general, a consolidated group generates a combined NOL at an aggregate level (CNOL), with the CNOL generally equal to the loss generated from treating the consolidated group as a single entity. Under regulations promulgated prior to the Tax Cuts and Jobs Act (TCJA), the allowed CNOL deduction was equal to the lesser of the CNOL carryover or the combined taxable income of the group (before the CNOL deduction).

The TCJA and the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) made several changes to section 172. First, the TCJA and the CARES Act disallowed the carry back of NOLs generated in taxable years beginning after 2020, except for farming losses and losses incurred by corporations that are insurance companies other than life insurance companies (nonlife insurance companies). Second, the TCJA and the CARES Act limited the NOL deduction in taxable years beginning after 2020 for NOLs generated in 2018 or later (post-2017 NOLs) to 80 percent of taxable income determined after the deduction for pre-2018 NOLs but before the deduction for post-2017 NOLs. This 80-percent limitation does not apply to nonlife insurance companies.

These proposed regulations implement the changes to section 172 in the context of consolidated groups. In particular, regulations are needed to address three issues related to consolidated groups that were not expressly addressed in the TCJA or the CARES Act. First, the proposed regulations describe how to determine the 80-percent limitation in the case of a "mixed" group – that is, a consolidated group containing nonlife insurance companies and other members. Second, the proposed regulations address the calculation and allocation of farming losses. Third, the proposed regulations implement the 80-percent limitation into existing regulations to determine the CNOL deduction attributable to losses a member arising during periods in which that member was not part of that group. Part I.B of this Special Analyses describes the

manner by which the proposed regulations addresses each of these issues.

Part I.B also describes an alternative approach that was contemplated by the Treasury Department and the IRS regarding the allocation of currently generated losses to nonlife insurance companies and other members. The Treasury Department and the IRS elected not to implement this approach.

#### *B. Overview of the Proposed Regulations*

In this part I.B the following terms are used. The term “P group” means a consolidated group of which P is the common parent. The term “P&C member” means a member of the P group that is a nonlife insurance company. The term “C member” means a member of the P group that is a corporation other than nonlife insurance company.

##### 1. Application of 80-percent limitation in mixed groups

Under the statute, the general rule for determining the NOL deduction (for a taxable year beginning after December 31, 2020) effectively proceeds in two steps. First, the taxpayer deducts pre-2018 NOLs without limit. Second, the taxpayer deducts post-2017 NOLs up to 80 percent of the taxpayer’s taxable income (computed without regard to the deductions under sections 172, 199A, and 250) determined after the deduction of pre-2018 NOLs (but, naturally, before the deduction for post-2017 NOLs). However, this 80-percent limitation does not apply for corporations that are nonlife insurance companies.

The application of the 80-percent limitation to the P group is straightforward if (i) there are no pre-2018 NOLs and (ii) both classes of P&C members and C members have positive income before the CNOL deduction. In that case, these proposed regulations provide, quite naturally, that the CNOL limitation is determined by adding (i) the pre-CNOL income generated by the class of C members (C member income pool), determined by applying the 80-percent limitation, plus (ii) 100 percent of the pre-CNOL income generated by the class of P&C members (P&C member income pool). This latter treatment reflects

the rule in section 172(f) that nonlife insurance companies are not subject to the 80-percent limitation.

One complication arises when the pre-CNOL C member income pool is positive and the pre-CNOL P&C income pool is negative, and the P group has positive combined pre-CNOL taxable income. In this case (where the pre-CNOL income is generated by C members, rather than P&C members), these proposed regulations provide that the post-2017 CNOL deduction limit is determined by applying the 80-percent limitation to the income of the P group. If the situation were reversed, such that the P group had positive combined taxable income but the pre-CNOL income is generated by P&C members, rather than the C members, the post-2017 CNOL deduction limit is equal to the income of the P group (that is, determined without regard to the 80-percent limitation). In essence, in these situations, the amount of the P group’s income able to absorb a post-2017 CNOL carryover is defined by the member pool (that is, the C member income pool or the P&C member income pool) that is generating the income.

The other complication occurs when there is a pre-2018 NOL. In this situation, it matters whether the pre-2018 NOL is treated as reducing the amount of the C member income pool or reducing the amount of P&C member income pool. Consider the following example (Example 1). In Example 1, the P group carries \$50 in pre-2018 NOLs and \$1000 in post-2017 NOLs to 2021. In 2021, the P&C members and the C members, respectively, earn (pre-CNOL) income of \$100. If the pre-2018 NOL were treated as solely reducing the amount of C member income pool, then the limitation for the post-2017 CNOL deduction would be \$100 plus 80 percent of \$50 (\$100 minus \$50), equal to \$140. If the pre-2018 NOL were treated as solely reducing the amount of the P&C member income pool, then the post-2017 CNOL deduction limit for the P group would be \$50 (\$100 minus \$50) plus 80 percent of \$100, or \$130.

These proposed regulations allocate the pre-2018 NOL pro-rata to the C member income pool and the P&C member income pool in proportion to their current-year income. In Example 1, \$25 of

the pre-2018 NOL would be allocated to the C member income pool and \$25 to the P&C member income pool. Therefore, the post-2017 CNOL deduction limit for the P group would be \$75 (\$100 minus \$25) plus 80 percent of \$75 (\$100 minus \$25), or \$135.

##### 2. Farming losses

Section 172 provides NOLs arising in a taxable year beginning after December 31, 2020, may not be carried back to prior years, with two exceptions: (1) farming losses and (2) nonlife insurance company losses. Section 172(b)(1)(B) defines a “farming loss” as the smaller of the actual loss from farming activities in a given year (that is, the excess of the deductions in farming activities over income in farming activities) and the total NOL generated in that year. This statutory provision means that if a taxpayer incurs a loss in farming activities but has overall income in other activities, the farming loss will be smaller than the loss in farming activities (and can possibly be zero).

Regulations were needed to clarify two issues that arise in the context of consolidated groups. First, these regulations clarify that the maximum amount of farming loss is the CNOL of the group rather than the NOL of the specific member generating the loss in farming activities. This approach closely follows regulations issued by the Treasury Department and the IRS in 2012 in an analogous setting.

Second, given the overlapping categories of carryback-eligible NOLs (farming losses and nonlife insurance companies), regulations are needed to allocate the farming loss to the various members to determine the total amount of CNOL that can be carried back. Consider the following example (Example 2). In Example 2, the P group consists of one C member and one P&C member. In 2021, the C member’s only activity is farming and the C member incurs a loss of \$30, while the P&C member incurs a loss of \$10. The total farming loss is \$30, since \$30 is less than the P group CNOL of \$40. If this farming loss were allocated entirely to the C member, then the total amount eligible for carryback would be \$40 (that is, \$30 for the farming loss and \$10 for the loss incurred by the P&C member). By contrast, if the

farming loss were allocated entirely to the P&C member, only \$30 would be eligible to be carried back.

Again, following a similar rule as the 2012 regulations, these proposed regulations allocate the farming loss to each member of the group in proportion with their share of total losses, without regard to whether each member actually engaged in farming. In Example 2, this would allocate \$7.50 (that is, one-fourth of \$30) of the farming loss to the P&C member and the remaining \$22.50 (that is, three-fourths of \$30) to the C member. Therefore, the P group would be allowed to carry back \$32.50 total (that is, the \$10 of loss generated by the P&C member and the \$22.50 of farming losses allocated to the C member).

### 3. Separate Return Loss Year Limitation

To reduce “loss trafficking,” existing regulations under section 1502 limit the extent to which a consolidated group (that is, the P group) can claim a CNOL attributable to losses generated by some member (M) in years in which M was not a member. In particular, existing rules limit this amount of loss to the amount of the loss that would have been deductible had M remained a separate entity; that is, the rules are designed to preserve neutrality in loss use between being a separate entity or a member of a group. Existing rules operationalize this principle using the mechanic of a “cumulative register.” The cumulative register is equal to the (cumulative) amount of M’s income that is taken into account in the P group’s income. Income earned by M while a member of the P group increases the cumulative register, while losses (carried over or otherwise) taken into account by the group reduce the cumulative register. In general, the existing rules provide that M’s pre-group NOLs cannot offset the P group’s income when the cumulative register is less than or equal to zero.

The introduction of the 80-percent limitation in the TCJA and CARES Act necessitates an adjustment to this mechanism in order to retain this neutrality-in-loss-use property. In particular, these proposed regulations provide that any losses by M that are absorbed by the P group and subject to the 80-percent limitation cause a reduc-

tion to the register equal to the full amount of income needed to support that deduction. The following example (Example 3) demonstrates why this adjustment is necessary. In Example 3, P and S are each corporations other than nonlife insurance companies (that is, they are subject to the 80-percent limitation). Suppose in 2021, S incurs a loss of \$800, which is the only loss incurred by S. In 2022, S incurs income of \$400. If S were not a member of a consolidated group, its 2022 NOL deduction would be limited to \$320 (80 percent of \$400). Suppose instead that P acquires S in 2022 and that P has separate income of \$600 in 2022, so the consolidated group has \$1000 in pre-CNOL income in 2022. Before claiming any CNOLs, S’s cumulative register would increase to \$400 in 2022. Without any additional rules, the \$400 cumulative register would allow P to claim a CNOL of \$400 (bringing the register down to zero), greater than what would have been allowed had S remained a separate entity. By contrast, requiring the register to be reduced by 125 percent of the NOL (as under the current NPRM) allows P to claim only a \$320 CNOL, replicating the result if S were a separate entity.

### 4. Allocation of current losses to nonlife insurance companies

In general, under the TCJA and CARES Act, taxpayers may not carry back any losses generated in tax years beginning after 2020, with the exception of losses generated by nonlife insurance companies and farming losses. Existing regulations clarify that CNOLs are allocated to each member in proportion to the total loss. This allocation rule can be illustrated by example (Example 4). In Example 4, the C member has a current loss of \$10 (in a tax year beginning in 2021 or later). The P&C members are corporations PC1 and PC2. PC1 has a gain of \$40 and PC2 has a loss of \$40. Assume that the P group does not engage in any farming activities. The CNOL for the P group is \$10. The \$10 of CNOL is allocated to the C member and PC2 in proportion to their total losses. The C member has one-fifth of the total loss (\$10 divided by \$50) and PC2 has four-fifths. Therefore, under the existing regulations, the C member is allocated \$2 (\$10 times one-fifth) and PC2 is allocated

\$8 (\$10 times four-fifths). In the end, \$8 of the CNOL may be carried back in Example 4. The proposed regulations do not alter these existing regulations.

In formulating these proposed regulations, the Treasury Department and the IRS contemplated an alternative approach. Under this alternative, consolidated groups would be required to compute gain and loss by grouping P&C members and C members separately prior to allocating CNOL to members. The application of this approach can be seen by revisiting Example 4. Under this alternative approach, because the P&C members as a whole do not have a loss, no CNOL would be allocated to any P&C member regardless of the gain or loss of any of the individual P&C members. Thus, under the alternative approach, none of the \$10 CNOL would be eligible for carryback in Example 4.

## C. Economic Analysis

### 1. Baseline

In this analysis, the Treasury Department and the IRS assess 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 regulations.

### 2. Summary of economic effects

The proposed regulations provide certainty and clarity to taxpayers regarding the treatment of NOLs under section 172 and the regulations under section 1502. In the absence of such guidance, the chance that different taxpayers would interpret the statute and the regulations differently would be exacerbated. Similarly situated taxpayers might interpret those rules differently, with one taxpayer pursuing an economic opportunity that another taxpayer might decline to make because of different interpretations of the ability of losses to offset taxable income. If this second taxpayer’s activity were more profitable, the resulting economic decisions are inefficient. Such situations are more likely to arise in the absence of guidance. While no guidance can curtail all differential or inaccurate interpretations of the statute, the regulations significantly mitigate the

chance for differential or inaccurate interpretations and thereby increase economic efficiency.

To the extent that the specific provisions of the proposed regulations result in the acceleration or delay of the tax year in which taxpayers deduct an NOL relative to the baseline, those taxpayers may face a change in the present value of the after-tax return to new investment, particularly investment that may result in losses. The resulting changes in the incentives facing the taxpayer are complex and may lead the taxpayer either to increase, decrease, or leave unchanged the volume and risk level of its investment portfolio, relative to the baseline, in ways that depend on the taxpayer's stock of NOLs and the depreciation schedules and income patterns of investments they would typically consider, including whether the investment is subject to bonus depreciation. Because these elements are complex and taxpayer-specific and because the sign of the effect on investment is generally ambiguous, the Treasury Department and the IRS have not projected the specific effects on economic activity arising from the proposed regulations.

The Treasury Department and the IRS project that any such effects will be small relative to the baseline. The effects are small because the regulations apply only to consolidated groups; in addition, several provisions of the proposed regulations apply only to the extent that a consolidated group contains a mix of member types. Moreover, the effects are small because: (i) for provisions of the proposed regulations that affect the deduction for pre-2018 NOLs, the effects are limited to the stock of the pre-2018 NOLs; and (ii) for provisions that affect the allowable rate of loss usage of post-2017 NOLs, the effect arises only from the 20 percentage point differential in the deduction for these NOLs. This latter effect in particular, to which the bulk of the provisions apply, is too small to substantially affect taxpayers' use of NOLs and thus too small to lead to meaningful changes in economic decisions.

The Treasury Department and the IRS have not provided quantitative estimates of the effects of these regulations relative to the baseline because they do not have readily available models that predict the

effects of these tax treatments of consolidated group NOLs on the investments or other activities that consolidated groups might undertake. The Treasury Department and the IRS solicit comments on this analysis and on the economic effects of these proposed regulations, and particularly solicit data, models, or other evidence that could enhance the rigor with which the final regulations are developed.

### 3. Allocation of CNOLs to specific members of consolidated groups

The proposed regulations do not amend existing rules for the allocation of the CNOL within consolidated groups. The proposed regulations follow existing rules and allocate the CNOLs to each member of the group in proportion to the total loss.

The Treasury Department and the IRS considered an alternative approach that would have required groups to compute gain and loss at the subgroup level prior to allocating CNOL to members. Recall Example 4 in which the PC subgroup had no gain or loss but the C subgroup had a loss of \$10. Under this alternative approach, because the PC subgroup as a whole does not have a loss, no CNOL would be allocated to any member in the PC group regardless of the gain or loss of any of the individual members of PC. Thus, in Example 4, none of the \$10 CNOL would be eligible for carryback.

The Treasury Department and the IRS recognize that as a result of the TCJA and the CARES Act the adopted approach of allocating losses to each member may provide groups with a potential incentive, relative to the alternative approach, to split their C members into several corporations – some with loss and some with gain. In certain circumstances, such a strategy would effectively enable some share of the losses generated by the other C members to be carried back. This change in the business structure of consolidated groups may entail economic costs because, to the extent this strategy is pursued, it would result from tax-driven rather than market-driven considerations. The Treasury Department and the IRS project, however, that the adopted approach will have lower compliance costs for taxpayers, relative to the alternative approach, because it generally follows existing regulatory practice

for allocating losses within a consolidated group.

The Treasury Department and the IRS have not attempted to estimate the economic consequences of either of these effects but project them to be small. The effects are projected to be small because (i) only a small number of taxpayers are likely to be affected; (ii) any reorganization that occurs due to the proposed regulations will primarily be "on paper" and entail little or no economic loss; and (iii) the compliance burden of loss allocation, under either the proposed regulations or the alternative approach, is not high.

### 4. Affected Taxpayers

The Treasury Department and the IRS project that these regulations will primarily affect consolidated groups that contain at least one nonlife insurance member and at least one member that is not a nonlife insurance company. Based on data from 2015, the Treasury Department and the IRS calculate that there were 1,130 such consolidated groups. Approximately 460 of these groups were of "mixed loss" status, meaning that at least one nonlife insurance member had a gain and one other member had a loss, or vice versa.

## II. Paperwork Reduction Act

For information regarding the collection of information in §1.1502-21(b)(3)(ii)(C) of these proposed regulations (including where to submit comments on this collection of information and on the accuracy of the estimated burden), please refer to the preamble to the temporary regulations under section 1502 published elsewhere in this issue of the **Federal Register**. This collection of information will be under Office of Management and Budget control number 1545-0123, the same control number as the collection of information in those temporary regulations, and the estimated burden of this collection of information is described in the preamble to those temporary regulations.

## III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby

certified that these proposed regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these proposed regulations apply only to corporations that file consolidated Federal income tax returns, and that such corporations almost exclusively consist of larger businesses. Specifically, based on data available to the IRS, corporations that file consolidated Federal income tax returns represent only approximately two percent of all filers of Forms 1120 (U.S. Corporation Income Tax Return). However, these consolidated Federal income tax returns account for approximately 95 percent of the aggregate amount of receipts provided on all Forms 1120. Therefore, these proposed regulations would not create additional obligations for, or impose an economic impact on, small entities. Accordingly, the Secretary certifies that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

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

#### **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. In 2020, that threshold is approximately \$156 million. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

#### **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 proposed rule does not have federalism implications, does not impose substantial direct compliance costs on state and local governments, and does not preempt state law within the meaning of the Executive Order.

#### **Comments and Requests for a Public Hearing**

Before the 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 this preamble under the “**ADDRESSEES**” heading. 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](http://www.regulations.gov) or upon request.

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

#### **Statement of Availability of IRS Documents**

IRS Revenue Procedures, Revenue Rulings, and Notices cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

#### **Drafting Information**

The principal authors of these proposed regulations are Justin O. Kellar, Gregory J. Galvin, and William W. Burhop of the Office of Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

#### **Partial Withdrawal of Notices of Proposed Rulemaking**

Accordingly, under the authority of 26 U.S.C. 1502 and 7805, §1.1502-21(b)(2)(iv)(C) of the notice of proposed rulemaking (REG-140668-07) published in the **Federal Register** (77 FR 57451) on September 17, 2012 is withdrawn, and §1.1502-21(b)(2)(iv)(B) of the notice of proposed rulemaking (REG-101652-10) published in the **Federal Register** (80 FR 33211) on June 11, 2015 is withdrawn.

#### **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 TAX**

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

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

Par. 2. Section 1.1502-1 is amended by adding paragraphs (k) and (l) to read as follows:

*§1.1502-1 Definitions.*

\* \* \* \* \*

(k) *Nonlife insurance company*. The term *nonlife insurance company* means a member that is an insurance company other than a *life insurance company*, each as defined in section 816(a).

(l) *Applicability date*. Paragraph (k) of this section applies to taxable years beginning after [EFFECTIVE DATE OF FINAL RULE].

Par. 3. Section 1.1502-21 is amended by:

1. Revising paragraph (a).
  2. Revising paragraph (b)(1).
  3. In paragraph (b)(2)(iv)(A), removing the language “shall equal the product of” with the language “equals the product obtained by multiplying”, and adding in its place “such member” with the language “the member”.
  4. Revising paragraph (b)(2)(iv)(B).
  5. Adding paragraphs (b)(2)(iv)(C) through (E).
  6. Revising paragraph (b)(2)(v) introductory text.
  7. In paragraph (b)(2)(v), redesignating *Examples 1* through *3* as paragraphs (b)(2)(v)(A) through (C), respectively.
  8. In newly redesignated paragraphs (b)(2)(v)(A) through (C), redesignating paragraphs (b)(2)(v)(A)(i) and (ii) as paragraphs (b)(2)(v)(A)(1) and (2), paragraphs (b)(2)(v)(B)(i) and (ii) as paragraphs (b)(2)(v)(B)(1) and (2), and paragraphs (b)(2)(v)(C)(i) and (ii) as paragraphs (b)(2)(v)(C)(1) and (2).
  9. Adding paragraphs (b)(2)(v)(D) through (G).
  10. In paragraph (b)(3)(ii)(B), removing the language “§ 1.1502-21(b)(3)(ii)(B)(2)” and adding in its place “§ 1.1502-21(b)(3)(ii)(B)”.
  11. Revising paragraph (b)(3)(ii)(C).
  12. Adding paragraph (b)(3)(ii)(D).
  13. Revising paragraph (c)(1)(i) introductory text.
  14. In paragraph (c)(1)(i)(C)(2), removing the language “and”.
  15. In paragraph (c)(1)(i)(D), removing the language “account.” and adding in its place “account; and”.
  16. Adding paragraph (c)(1)(i)(E).
  17. In paragraph (c)(1)(iii) introductory text, adding a new first sentence.
  18. In paragraph (c)(1)(iii), designating *Examples 1* through *5* as paragraphs (c)(1)(iii)(A) through (E), respectively.
  19. In newly redesignated paragraphs (c)(1)(iii)(A) through (E), redesignating paragraphs (c)(1)(iii)(A)(i) through (iii) as paragraphs (c)(1)(iii)(A)(1) through (3), paragraphs (c)(1)(iii)(B)(i) through (vi) as paragraphs (c)(1)(iii)(B)(1) through (6), paragraphs (c)(1)(iii)(C)(i) through (iii) as paragraphs (c)(1)(iii)(C)(1) through (3), paragraphs (c)(1)(iii)(D)(i) through (iv) as paragraphs (c)(1)(iii)(D)(1) through (4), and paragraphs (c)(1)(iii)(E)(i) through (v) as paragraphs (c)(1)(iii)(E)(1) through (5).
  20. In newly redesigned paragraph (c)(1)(iii)(C)(2), adding the language “, a taxable year that begins on January 1, 2021” after the language “at the beginning of Year 4”.
  21. Revising paragraphs (c)(1)(iii)(D)(2) through (4).
  22. Adding paragraph (c)(1)(iii)(D)(5).
  23. Revising paragraphs (c)(1)(iii)(E)(2) through (5).
  24. Adding paragraphs (c)(1)(iii)(E)(6) and (c)(1)(iii)(F).
  25. Revising paragraph (c)(2)(v).
  26. In paragraph (c)(2)(viii) introductory text, adding a new first sentence.
  27. In paragraph (c)(2)(viii), redesignating *Examples 1* through *4* as paragraphs (c)(2)(viii)(A) through (D), respectively.
  28. In newly redesigned paragraphs (c)(2)(viii)(A) through (D), redesignating paragraphs (c)(2)(viii)(A)(i) through (vii) as paragraphs (c)(2)(viii)(A)(1) through (7), paragraphs (c)(2)(viii)(B)(i) through (iv) as paragraphs (c)(2)(viii)(B)(1) through (4), paragraphs (c)(2)(viii)(C)(i) through (iii) as paragraphs (c)(2)(viii)(C)(1) through (3), and paragraphs (c)(2)(viii)(D)(i) and (ii) as paragraphs (c)(2)(viii)(D)(1) and (2).
  29. In newly redesigned paragraphs (c)(2)(viii)(A)(3) through (7), the first sentence of each, adding the language “, including the limitation under paragraph (c)(1)(i)(E) of this section” after the language “under paragraph (c) of this section”.
  30. In newly redesigned paragraph (c)(2)(viii)(B)(1), the first sentence, adding the language “, none of which is a nonlife insurance company” after the language “S, T, P and M”.
  31. In newly redesigned paragraph (c)(2)(viii)(B)(1), the fourth sentence, adding the language “(a taxable year beginning after December 31, 2020)” after the language “Year 3”.
  32. Revising newly designated paragraph (c)(2)(viii)(B)(3).
  33. Redesignating newly redesigned paragraph (c)(2)(viii)(B)(4) as paragraph (c)(2)(viii)(B)(5).
  34. Adding a new paragraph (c)(2)(viii)(B)(4).
  35. Revising newly redesigned paragraph (c)(2)(viii)(B)(5).
  36. Adding paragraph (c)(2)(viii)(B)(6).
  37. In paragraph (g)(5), redesignating *Examples 1* through *9* as paragraphs (g)(5)(i) through (ix), respectively.
  38. In newly redesigned paragraphs (g)(5)(i) through (ix), redesignating paragraphs (g)(5)(i)(i) through (iv) as paragraphs (g)(5)(i)(A) through (D), paragraphs (g)(5)(ii)(i) through (iv) as paragraphs (g)(5)(ii)(A) through (D), paragraphs (g)(5)(iii)(i) through (iii) as paragraphs (g)(5)(iii)(A) through (C), paragraphs (g)(5)(iv)(i) through (iv) as paragraphs (g)(5)(iv)(A) through (D), paragraphs (g)(5)(v)(i) through (iv) as paragraphs (g)(5)(v)(A) through (D), paragraphs (g)(5)(vi)(i) through (iv) as paragraphs (g)(5)(vi)(A) through (D), paragraphs (g)(5)(vii)(i) through (vi) as paragraphs (g)(5)(vii)(A) through (F), paragraphs (g)(5)(viii)(i) through (v) as paragraphs (g)(5)(viii)(A) through (E), and paragraphs (g)(5)(ix)(i) through (vii) as paragraphs (g)(5)(ix)(A) through (G).
  39. Revising paragraph (h)(9).
  40. Adding paragraph (h)(10).
- The revisions and additions read as follows:
- §1.1502-21 Net operating losses.*
- (a) *Consolidated net operating loss deduction*—(1) *In general.* Subject to any limitations under the Internal Revenue Code or this chapter (for example, the limitations under section 172(a)(2) and paragraph (a)(2) of this section), the consolidated net operating loss deduction (or CNOL deduction) for any consolidated return year is the aggregate of the net operating loss carryovers and carrybacks to the year. The net operating loss carryovers and carrybacks consist of—
    - (i) Any CNOLs (as defined in paragraph (e) of this section) of the consolidated group; and
    - (ii) Any net operating losses (or NOLs) of the members arising in separate return years.
  - (2) *Application of section 172 for computing net operating loss deductions*—(i) *Overview.* For purposes of §1.1502-11(a)(2) (regarding a CNOL deduction), the rules of section 172 regarding the use of net operating losses are taken into account as provided by this paragraph (a)(2) in calculating the consolidated taxable income of a group for a particular consolidated return year. More specifically, the aggregate amount of net operating losses arising in

taxable years beginning before January 1, 2018 (pre-2018 NOLs) carried to a particular consolidated return year beginning after December 31, 2020, is added to the group's post-2017 CNOL deduction limit (as determined under this paragraph (a)(2)) for such year for purposes of determining the total CNOL deduction allowed for such year. See section 172(a)(2)(A) and (B).

(ii) *Computation of the 80-percent limitation and special rule for nonlife insurance companies*—(A) *Determinations based on status of group members*. If a portion of a CNOL arising in a taxable year beginning after December 31, 2017 (post-2017 CNOL), is carried back or carried over to a consolidated return year beginning after December 31, 2020, whether the members of the group include nonlife insurance companies, other types of corporations, or both determines whether section 172(a) (including the limitation described in section 172(a)(2)(B) (80-percent limitation)), section 172(f), or both, apply to the group for the consolidated return year.

(B) *Determination of post-2017 CNOL deduction limit*. The amount of post-2017 CNOLs that may be absorbed by one or more members of the group in a consolidated return year beginning after December 31, 2020 (post-2017 CNOL deduction limit) is determined under paragraph (a)(2)(iii) of this section by applying section 172(a)(2)(B) (that is, the 80-percent limitation), section 172(f) (that is, the special rule for nonlife insurance companies), or both, to the group's consolidated taxable income for that year.

(C) *Inapplicability of 80-percent limitation*. The 80-percent limitation does not apply to CNOL deductions taken in taxable years beginning before January 1, 2021, or to CNOLs arising in taxable years beginning before January 1, 2018 (that is, pre-2018 CNOLs). See section 172(a).

(iii) *Computations under sections 172(a)(2)(B) and 172(f)*. This paragraph (a)(2)(iii) provides rules for applying sections 172(f) and 172(a)(2)(B) to consolidated return years beginning after December 31, 2020 (that is, for computing the post-2017 CNOL deduction limit). Section 172(f) applies to income of nonlife insurance company members, where as section 172(a)(2)(B) applies to income

of members that are not nonlife insurance companies. Thus, this paragraph (a)(2)(iii) provides specific rules for groups with no nonlife insurance company members, only nonlife insurance company members, or a combination of nonlife insurance company members and other members.

(A) *Groups without nonlife insurance company members*. If no member of a group is a nonlife insurance company during a particular consolidated return year beginning after December 31, 2020, section 172(a)(2)(B) (that is, the 80-percent limitation) applies to all income of the group for that year. Therefore, the post-2017 CNOL deduction limit for the group for that year is the lesser of—

(1) The aggregate amount of post-2017 NOLs carried to that year; or

(2) The amount determined by multiplying—

(i) 80 percent, by

(ii) Consolidated taxable income for the group for that year (determined without regard to any deductions under sections 172, 199A, and 250) less the aggregate amount of pre-2018 NOLs carried to that year.

(B) *Groups comprised solely of nonlife insurance companies*. If a group is comprised solely of nonlife insurance companies during a particular consolidated return year beginning after December 31, 2020, section 172(f) applies to all income of the group for that year. Therefore, the post-2017 CNOL deduction limit for the group for that year equals consolidated taxable income less the aggregate amount of pre-2018 NOLs carried to that year.

(C) *Groups that include both nonlife insurance companies and other corporations*—(1) *General rule*. Except as provided in paragraph (a)(2)(iii)(C)(5) of this section, if a group has at least one member that is a nonlife insurance company and at least one member that is not a nonlife insurance company during a particular consolidated return year beginning after December 31, 2020, the post-2017 CNOL deduction limit for the group for that year equals the sum of the amounts determined under paragraphs (a)(2)(iii)(C)(2) and (3) of this section.

(2) *Residual income pool*. The amount determined under this paragraph (a)(2)(iii)(C)(2) is the lesser of—

(i) The aggregate amount of post-2017 NOLs carried to a consolidated return year beginning after December 31, 2020, or

(ii) Eighty percent of the consolidated taxable income of the group for that year (determined without regard to any income, gain, deduction, or loss of members that are nonlife insurance companies and without regard to any deductions under sections 172, 199A, and 250) (residual income pool) after subtracting the aggregate amount of pre-2018 NOLs carried to that year that are allocated to the residual income pool under paragraph (a)(2)(iii)(C)(4) of this section (that is, by applying the 80-percent limitation). See section 172(a)(2)(B).

(3) *Nonlife income pool*. The amount determined under this paragraph (a)(2)(iii)(C)(3) is the consolidated taxable income of the group for a consolidated return year beginning after December 31, 2020 (determined without regard to any income, gain, deduction, or loss of members included in the computation under paragraph (a)(2)(iii)(C)(2) of this section) (nonlife income pool) less the aggregate amount of pre-2018 NOLs carried to that year that are allocated to the nonlife income pool under paragraph (a)(2)(iii)(C)(4) of this section. See section 172(f).

(4) *Pro rata allocation of pre-2018 NOLs between pools of income*. For purposes of paragraphs (a)(2)(iii)(C)(2) and (3) of this section, the aggregate amount of pre-2018 NOLs carried to any particular consolidated return year beginning after December 31, 2020, is prorated between the residual income pool and the nonlife income pool based on the relative amounts of positive income of those two pools. For example, if \$30 of pre-2018 NOLs is carried over to a year in which the residual income pool contains \$75 and the nonlife income pool contains \$150, the residual income pool is allocated \$10 of the pre-2018 NOLs ( $\$30 \times \$75 / (\$75 + \$150)$ , or  $\$30 \times 1/3$ ), and the nonlife income pool is allocated the remaining \$20 of pre-2018 NOLs ( $\$30 \times \$150 / (\$75 + \$150)$ , or  $\$30 \times 2/3$ ).

(5) *Exception*. The post-2017 CNOL deduction limit for the group for a consolidated return year is determined under this paragraph (a)(2)(iii)(C)(5) if the amounts computed under paragraphs (a)(2)(iii)(C)(2) and (3) of this section for that year are not both positive.

(i) *Positive residual income pool and negative nonlife income pool.* This paragraph (a)(2)(iii)(C)(5)(i) applies if the amount computed under paragraph (a)(2)(iii)(C)(2) of this section for the residual income pool is positive and the amount computed under paragraph (a)(2)(iii)(C)(3) of this section for the nonlife income pool is negative. If this paragraph (a)(2)(iii)(C)(5)(i) applies, the post-2017 CNOL deduction limit for the group for a consolidated return year equals the lesser of the aggregate amount of post-2017 NOLs carried to that year, or 80 percent of the consolidated taxable income of the entire group (determined without regard to any deductions under sections 172, 199A, and 250) after subtracting the aggregate amount of pre-2018 NOLs carried to that year (that is, by applying the 80-percent limitation). See section 172(a)(2)(B).

(ii) *Positive nonlife income pool and negative residual income pool.* If the amount computed under paragraph (a)(2)(iii)(C)(3) of this section for the nonlife income pool is positive and the amount computed under paragraph (a)(2)(iii)(C)(2) of this section for the residual income pool is negative, the post-2017 CNOL deduction limit for the group for a consolidated return year equals the consolidated taxable income of the entire group less the aggregate amount of pre-2018 NOLs carried to that year. See section 172(f).

(b) \* \* \*

(1) *Carryovers and carrybacks generally.* The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of, and are subject to any limitations under, section 172 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. In addition, except as otherwise provided in this section, the amount of any CNOL absorbed by the group in any year is apportioned among members based on the percentage of the CNOL eligible for carryback or carryover that is attributable to each member as of the beginning of the year. The percentage of the CNOL attributable to a member is determined pursuant to paragraph (b)(2)(iv)(B)

of this section. Additional rules provided under the Internal Revenue Code or regulations also apply. See, for example, section 382(l)(2)(B) (if losses are carried from the same taxable year, losses subject to limitation under section 382 are absorbed before losses that are not subject to limitation under section 382). See paragraph (c)(1)(iii) of this section, Example 2, for an illustration of pro rata absorption of losses subject to a SRLY limitation.

(2) \* \* \*  
(iv) \* \* \*

(B) *Percentage of CNOL attributable to a member—(I) In general.* Except as provided in paragraph (b)(2)(iv)(B)(2) of this section, the percentage of the CNOL for the consolidated return year attributable to a member equals the separate net operating loss of the member for the consolidated return year divided by the sum of the separate net operating losses for that year of all members having such losses for that year. For this purpose, the separate net operating loss of a member is determined by computing the CNOL by reference to only the member's items of income, gain, deduction, and loss, including the member's losses and deductions actually absorbed by the group in the consolidated return year (whether or not absorbed by the member).

(2) *Recomputed percentage.* If, for any reason, a member's portion of a CNOL is absorbed or reduced on a non-pro rata basis (for example, under §1.1502-11(b) or (c), paragraph (b)(2)(iv)(C) of this section, §1.1502-28, or §1.1502-36(d), or as the result of a carryback to a separate return year), the percentage of the CNOL attributable to each member is recomputed. In addition, if a member with a separate net operating loss ceases to be a member, the percentage of the CNOL attributable to each remaining member is recomputed. The recomputed percentage of the CNOL attributable to each member equals the remaining CNOL attributable to the member at the time of the recomputation divided by the sum of the remaining CNOL attributable to all of the remaining members at the time of the recomputation. For purposes of this paragraph (b)(2)(iv)(B)(2), a CNOL that is permanently disallowed or eliminated is treated as absorbed.

(C) *Net operating loss carryovers and carrybacks—(I) General rules.* Subject to

the rules regarding allocation of special status losses under paragraph (b)(2)(iv)(D) of this section—

(i) *Nonlife insurance companies.* The portion of a CNOL attributable to any members of the group that are nonlife insurance companies is carried back or carried over under the rules in section 172(b) applicable to nonlife insurance companies.

(ii) *Corporations other than nonlife insurance companies.* The portion of a CNOL attributable to any other members of the group is carried back or carried over under the rules in section 172(b) applicable to corporations other than nonlife insurance companies.

(2) *Recomputed percentage.* For rules governing the recomputation of the percentage of a CNOL attributable to each remaining member if any portion of the CNOL attributable to a member is carried back under section 172(b)(1)(B) or (C) and absorbed on a non-pro rata basis, see paragraph (b)(2)(iv)(B)(2) of this section.

(D) *Allocation of special status losses.* The amount of the group's CNOL that is determined to constitute a farming loss (as defined in section 172(b)(1)(B)) or any other net operating loss that is subject to special carryback or carryover rules (special status loss) is allocated to each member separately from the remainder of the CNOL based on the percentage of the CNOL attributable to the member, as determined under paragraph (b)(2)(iv)(B) of this section. This allocation is made without regard to whether a particular member actually incurred specific expenses or engaged in specific activities required by the special status loss provisions. This paragraph (b)(2)(iv)(D) applies only with regard to losses for which the special carryback or carryover rules are dependent on the type of expense generating the loss, rather than on the special status of the entity to which the loss is allocable. See section 172(b)(1)(C) and paragraph (b)(2)(iv)(C)(1)(i) of this section (applicable to losses of nonlife insurance companies). This paragraph (b)(2)(iv)(D) does not apply to farming losses incurred by a consolidated group in any taxable year beginning after December 31, 2017, and before January 1, 2021.

(E) *Coordination with rules for life-nonlife groups under §1.1502-47.* For groups that include at least one member that is a life insurance company and for

which an election is in effect under section 1504(c)(2), see §1.1502-47.

(v) *Examples.* For purposes of the examples in this paragraph (b)(2)(v), unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, all losses are farming losses within the meaning of section 172(b)(1)(B)(ii), all taxable years begin after December 31, 2020, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this paragraph (b) are illustrated by the following examples:

\* \* \* \*

(D) *Example 4: Allocation of a CNOL arising in a consolidated return year beginning after December 31, 2020.* (1) P is the common parent of a consolidated group that includes S. Neither P nor S is a nonlife insurance company. The P group also includes nonlife insurance companies PC1, PC2, and PC3. In the P group's 2021 consolidated return year, all members except S have separate net operating losses, and the P group's CNOL in that year is \$40. No member of the P group engages in farming activities. See section 172(b)(1)(B)(ii).

(2) Under paragraphs (b)(1) and (b)(2)(iv)(B)(1) of this section, for purposes of carrying losses to other taxable years, the P group's \$40 CNOL is allocated pro rata among the group members that have separate net operating losses. Under paragraph (b)(2)(iv)(C) of this section, those respective portions of the CNOL attributable to PC1, PC2, and PC3 (that is, members that are nonlife insurance companies) are carried back to each of the two preceding taxable years and then carried over to each of the 20 subsequent taxable years. See section 172(b)(1)(B)(ii).

See section 172(b)(1)(C). The portion attributable to P (which is not a nonlife insurance company) may not be carried back but is carried over to future years. See section 172(b)(1)(A).

(E) *Example 5: Allocation of a CNOL arising in a consolidated return year beginning before January 1, 2021.* The facts are the same as in paragraph (b)(2)(v)(D)(1) of this section, except that the P group incurred the CNOL during the P group's 2020 consolidated return year. The allocation among the P group members of the CNOL described in paragraph (b)(2)(v)(D)(2) of this section would be the same. However, those respective portions of the CNOL attributable to PC1, PC2, and PC3 (that is, members that are nonlife insurance companies) will be carried back to each of the five preceding taxable years and then carried over to each of the 20 subsequent taxable years. See section 172(b)(1)(C) and section 172(b)(1)(D)(i). The portion attributable to P (which is not a nonlife insurance company) will be carried back to each of the five preceding taxable years and then carried over to future years. See section 172(b)(1)(A) and section 172(b)(1)(D)(i).

(F) *Example 6: CNOL deduction and application of section 172.* (1) P (a type of corporation other than a nonlife insurance company) is the common parent of a consolidated group that includes PC1 (a nonlife insurance company). P and PC1 were both incorporated in Year 1 (a year beginning after December 31, 2020). In Year 1, P and PC1 have separate taxable income of \$20 and \$25, respectively. As a result, the P group has Year 1 consolidated taxable income of \$45. In Year 2, P has separate taxable income of \$24, and PC1 has a separate taxable loss of \$40. Thus, the P group has a Year 2 CNOL of \$16. No member of the P group engages in farming activities. See section 172(b)(1)(B)(ii).

(2) Under paragraph (b)(2)(iv)(B) of this section, the P group's Year 2 CNOL is entirely attributable to PC1, a nonlife insurance company. Therefore, under section 172(b)(1)(C)(i), the P group may carry back to Year 1 all \$16 of its Year 2 CNOL.

(3) Under paragraph (a)(2)(ii) of this section, the amount of the Year 2 CNOL that may be used by

the P group in Year 1 is determined by taking into account the status (nonlife insurance company or other type of corporation) of the member that has separate taxable income composing in whole or in part the P group's consolidated taxable income. Because the P group includes both a nonlife insurance company member and a member that is not a nonlife insurance company, paragraph (a)(2)(iii)(C) of this section applies to determine the computation of the post-2017 CNOL deduction limit for the group for Year 1. Therefore, the 80-percent limitation is applied to the residual income pool, which consists of the taxable income of P, a type of corporation other than a nonlife insurance company. Under the 80-percent limitation, the amount of P's Year 1 income that may be offset by the P group's Year 2 CNOL is \$16, which equals the lesser of the aggregate amount of post-2017 NOLs carried to Year 1 (\$16), or 80 percent of the excess of P's taxable income for that year (\$20) over the aggregate amount of pre-2018 NOLs allocable to P (\$0), which also is \$16 (80 percent x (\$20 - \$0)). See paragraph (a)(2)(iii)(C)(2) and (4) of this section. PC1 is a nonlife insurance company to which section 172(f), rather than the 80-percent limitation, applies. Therefore, the amount of PC1's Year 1 income that may be offset by the P group's Year 2 CNOL is \$25, which equals the excess of PC1's taxable income for Year 1 (\$25) over the aggregate amount of pre-2018 NOLs allocable to PC1 (\$0). See paragraph (a)(2)(iii)(C)(3) and (4) of this section.

(4) Based on the analysis set forth in paragraph (b)(2)(v)(F)(3) of this section, the P group's post-2017 CNOL deduction limit for Year 1 is \$41 (\$16 + \$25). Because the P group's Year 2 CNOL is \$16, this amount would offset the Year 1 income of the P group.

(G) *Example 7: Pre-2018 and post-2017 CNOLs.* (1) P is the common parent of a consolidated group. No member of the P group is a nonlife insurance company or is engaged in a farming business, and no member of the P group has a loss that is subject to a SRLY limitation. The P group had the following consolidated taxable income or CNOL for the following taxable years:

Table 1 to paragraph (b)(2)(v)(G)(1)

2014	2015	2016	2017	2018	2019	2020	2021
\$60	\$0	\$0	(\$90)	\$30	(\$40)	(\$100)	\$120

(2) Under section 172(a)(1), all \$30 of the P group's 2018 consolidated taxable income is offset by the 2017 CNOL carryover without limitation. The remaining \$60 of the P group's 2017 CNOL is carried over to 2021 under section 172(b)(1)(A)(ii)(I).

(3) Under section 172(b)(1)(D)(i)(I), the P group's \$40 2019 CNOL is carried back to the five taxable years preceding the year of the loss. Thus, the P group's \$40 2019 CNOL is carried back to offset \$40 of its 2014 consolidated taxable income.

(4) Under section 172(a)(2) and paragraph (a)(2)(i) of this section, the P group's CNOL deduction for 2021 equals the aggregate amount of pre-2018 NOLs carried to 2021 plus the group's post-2017 CNOL deduction limit. The P group has \$60 of pre-2018 NOLs carried to 2021 (\$90 - \$30). Because no member of the P group is a nonlife insurance company, paragraph (a)(2)(iii)(A) of this section applies to

determine the computation of the group's post-2017 CNOL deduction limit for 2021. See also section 172(a)(2)(B). Therefore, the post-2017 CNOL deduction limit of the P group for 2021 is \$48, which equals the lesser of the aggregate amount of post-2017 NOLs carried to 2021 (\$100), or 80 percent of the excess of the P group's consolidated taxable income for that year computed without regard to any deductions under sections 172, 199A, and 250 (\$120) over the aggregate amount of pre-2018 NOLs carried to 2021 (\$60) (that is, 80 percent x \$60). Thus, the P group's CNOL deduction for 2021 equals \$108 (\$60 pre-2018 NOLs carried to 2021 + \$48 post-2017 CNOL deduction limit). See section 172(a)(2) and paragraph (a)(2)(i) of this section. The P group offsets \$108 of its \$120 of 2021 consolidated taxable income, resulting in \$12 of consolidated taxable income in 2021. The remaining \$52 of the P

group's 2020 CNOL (\$100 - \$48) is carried over to future taxable years. See section 172(b)(1)(A)(ii)(II).

(3) \* \* \*

(ii) \* \* \*

(C) [The text of proposed §1.1502-21(b)(3)(ii)(C) is the same as the text of §1.1502-21T(b)(3)(ii)(C) published elsewhere in this issue of the **Federal Register**.]

(D) [The text of proposed §1.1502-21(b)(3)(ii)(D) is the same as the text of §1.1502-21T(b)(3)(ii)(D) published elsewhere in this issue of the **Federal Register**.]

\* \* \* \*

(c) \* \* \*  
(1) \* \* \*

(i) *General rule.* Except as provided in paragraph (g) of this section (relating to an overlap with section 382), the aggregate of the net operating loss carryovers and carrybacks of a member (SRLY member) arising (or treated as arising) in SRLYs (SRLY NOLs) that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate consolidated taxable income for all consolidated return years of the group determined by reference to only the member's items of income, gain, deduction, and loss (cumulative register). For this purpose—

\* \* \* \* \*

(E) If a limitation on the amount of taxable income that may be offset under section 172(a) (see paragraph (a)(2) of this section) applies in a taxable year to a member whose carryovers or carrybacks are subject to a SRLY limitation (SRLY member), the amount of net operating loss subject to a SRLY limitation that is available for use by the group in that year is limited to the percentage of the balance in the cumulative register that would be available for offset under section 172(a) if the SRLY member filed a separate return and reported as taxable income in that year the amount contained in the cumulative register. For example, assume that a consolidated group has a SRLY member that is a corporation other than a nonlife insurance company, and that the SRLY member has a SRLY NOL that arose in a taxable year beginning after December 31, 2017 (post-2017 NOL). The group's consolidated taxable income for a consolidated return year beginning after December 31, 2020 is \$200, but the cumulative register has a positive balance of only \$120 (and no other net operating loss carryovers or carrybacks are available for the year). Because the SRLY limitation would be \$96 ( $\$120 \times 80$  percent), only \$96 of SRLY loss may be used, rather than \$160 ( $\$200 \times 80$  percent). In addition, to the extent that this paragraph (c)(1)(i)(E) applies, the cumulative register is decreased by the full amount of income required under section 172(a) to support the amount of SRLY NOL absorption. See, for example, paragraph (c)(1)(iii)(A) and (B) of this section

for examples illustrating the application of this rule.

\* \* \* \* \*

(iii) \* \* \* For purposes of the examples in this paragraph (c)(1)(iii), no corporation is a nonlife insurance company and, unless otherwise specified, all taxable years begin after December 31, 2020, and all CNOLs arise in taxable years beginning after December 31, 2020. \* \* \*

(A) \* \* \*

(2) T's \$100 net operating loss carryover from Year 1 arose in a SRLY. See §1.1502-1(f)(2)(iii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, the \$100 net operating loss carryover is subject to the SRLY limitation in paragraph (c)(1) of this section. The positive balance of the cumulative register of T for Year 2 equals the consolidated taxable income of the P group determined by reference to only T's items, or \$70. However, due to the 80-percent limitation and the application of paragraph (c)(1)(i)(E) of this section, the SRLY limitation is \$56 ( $\$70 \times 80$  percent). No losses from equivalent years are available, and the P group otherwise has sufficient consolidated taxable income to support the CNOL deduction ( $\$300 \times 80$  percent = \$240). Therefore, \$56 of the SRLY net operating loss is included under paragraph (a) of this section in the P group's CNOL deduction for Year 2. Although only \$56 is absorbed, the cumulative register of T is reduced by \$70, the full amount of income necessary to support the \$56 deduction after taking into account the 80-percent limitation ( $\$70 \times 80$  percent = \$56).

\* \* \* \* \*

(B) \* \* \*

(2) P's Year 1, Year 2, and Year 3 are not SRLYs with respect to the P group. See §1.1502-1(f)(2)(i). Thus, P's \$40 net operating loss arising in Year 1 and \$120 net operating loss arising in Year 3 are not subject to the SRLY limitation under paragraph (c) of this section. Although the P group has \$160 of taxable income in Year 4, the 80-percent limitation reduces the P group's net operating loss deduction in that year to \$128 ( $\$160 \times 80$  percent). Under the principles of section 172, paragraph (b) of this section requires that P's \$40 loss arising in Year 1 be the first loss absorbed by the P group in Year 4. Absorption of this loss leaves \$88 ( $\$128 - \$40$ ) of the P group's Year 4 consolidated taxable income available for offset by loss carryovers.

(3) T's Year 2 and Year 3 are SRLYs with respect to the P group. See §1.1502-1(f)(2)(ii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, T's \$50 net operating loss arising in Year 2 and \$60 net operating loss arising in Year 3 are subject to the SRLY limitation. The positive balance of the cumulative register of T for Year 4 equals the P group's consolidated taxable income determined by reference to only T's items, or \$70. Under paragraph (c)(1)(i)(E) of this section, after taking into account the 80-percent limitation, T's SRLY limitation is \$56 ( $\$70 \times 80$  percent). Therefore, the P group can absorb up to \$56 of T's SRLY net operating losses in Year 4. Under the principles of section 172, T's \$50 SRLY net operating loss from Year 2 is included under paragraph (a) of this section in the P group's CNOL deduction for Year 4. After

absorption of this loss, under paragraph (c)(1)(i) of this section, \$6 of SRLY limit remains in Year 4 (\$56 - \$50). Further, the total amount of Year 4 consolidated taxable income available for offset by other loss carryovers under section 172(a) is \$38 ( $\$88 - \$50$ ).

(4) P and T each carry over net operating losses to Year 4 from a taxable year ending on the same date (that is, Year 3). The losses carried over from Year 3 total \$180. However, the remaining Year 4 SRLY limit is \$6. Therefore, the total amount of loss available for absorption is \$126 ( $\$120$  allocable to P and \$6 allocable to T). Under paragraph (b) of this section, the losses available for absorption that are carried over from Year 3 are absorbed on a pro rata basis, even though one loss arises in a SRLY and the other loss does not. Thus, \$36.19 of P's Year 3 loss is absorbed ( $\$120 / (\$120 + \$6)$ ) x \$38 = \$36.19. In addition, \$1.81 of T's Year 3 loss is absorbed ( $\$6 / (\$120 + \$6)$ ) x \$38 = \$1.81.

(5) After deduction of T's SRLY net operating losses in Year 4, the cumulative register of T is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. A total of \$51.81 of SRLY net operating losses were absorbed in Year 4 ( $\$50 + \$1.81$ ). After taking into account the 80-percent limitation, the amount of income necessary to support this deduction is \$64.76 ( $\$64.76 \times 80$  percent = \$51.81). Therefore, the cumulative register of T is decreased by \$64.76, and \$5.24 remains in the cumulative register ( $\$70 - \$64.76$ ).

(6) P carries its remaining \$83.81 ( $\$120 - \$36.19$ ) Year 3 net operating loss and T carries its remaining \$58.19 ( $\$60 - \$1.81$ ) Year 3 net operating loss over to Year 5. Assume that, in Year 5, the P group has \$90 of consolidated taxable income (computed without regard to the CNOL deduction). The P group's consolidated taxable income determined by reference to only T's items is a CNOL of \$4. Therefore, the positive balance of the cumulative register of T in Year 5 equals \$1.24 ( $\$5.24 - \$4$ ). Under paragraph (c)(1)(i)(E) of this section, after taking into account the 80-percent limitation, T's SRLY limitation is \$0.99 ( $\$1.24 \times 80$  percent). For Year 5, the total amount of Year 5 consolidated taxable income available for offset by loss carryovers as a result of the 80-percent limitation is \$72 ( $\$90 \times 80$  percent). Under paragraph (b) of this section, the losses carried over from Year 3 are absorbed on a pro rata basis, even though one loss arises in a SRLY and the other loss does not. Therefore, \$71.16 of P's Year 3 loss is absorbed ( $((\$83.81 / (\$83.81 + \$0.99)) \times \$72 = \$71.16$ ). In addition, \$0.83 of T's Year 3 losses is absorbed ( $((\$0.99 / (\$83.81 + \$0.99)) \times \$72 = \$0.83$ ).

\* \* \* \* \*

(D) \* \* \*

(2) Under §1.1502-15(a), T's \$100 of ordinary loss in Year 3 constitutes a built-in loss that is subject to the SRLY limitation under paragraph (c) of this section. The amount of the limitation is determined by treating the deduction as a net operating loss carryover from a SRLY. The built-in loss is therefore subject to both a SRLY limitation and the 80-percent limitation for Year 3. The built-in loss is treated as a net operating loss carryover solely for purposes of determining the extent to which the loss is not allowed by reason of the SRLY limitation, and for all other purposes the loss remains a loss arising in Year 3. See §1.1502-21(c)(1)(i)(D). Consequently, under paragraph (b) of this section, the built-in loss is absorbed by the P group before the net operating

loss carryover from Year 1 is absorbed. The positive balance of the cumulative register of T for Year 3 equals the P group's consolidated taxable income determined by reference to only T's items, or \$60. Under paragraph (c)(1)(i)(E) of this section, after taking into account the 80-percent limitation, the SRLY limitation for Year 3 is \$48 (\$60 x 80 percent). Therefore, \$48 of the built-in loss is absorbed by the P group. None of T's \$100 SRLY net operating loss carryover from Year 1 is allowed.

(3) After deduction of T's \$48 SRLY built-in loss in Year 4, the cumulative register of T is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. After taking into account the 80-percent limitation, the amount of income necessary to support this deduction is \$60 (\$60 x 80 percent = \$48). Therefore, the cumulative register of T is decreased by \$60, and zero remains in the cumulative register (\$60 - \$60).

(4) Under §1.1502-15(a), the \$52 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation and the 80-percent limitation is treated as a \$52 net operating loss arising in Year 3 that is subject to the SRLY limitation because, under paragraph (c)(1)(ii) of this section, Year 3 is treated as a SRLY. The built-in loss is carried to other years in accordance with the rules of paragraph (b) of this section. The positive balance of the cumulative register of T for Year 4 equals \$40 (zero from Year 3 + \$40). Under paragraph (c)(1)(i)(E) of this section, after taking into account the 80-percent limitation, the SRLY limitation for Year 4 is \$32 (\$40 x 80 percent). Therefore, under paragraph (c) of this section, \$32 of T's \$100 net operating loss carryover from Year 1 is included in the CNOL deduction under paragraph (a) of this section in Year 4.

(5) After deduction of T's \$32 SRLY net operating loss in Year 4, the cumulative register of T is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. After taking into account the 80-percent limitation, the amount of income necessary to support this deduction is \$40 (\$40 x 80 percent = \$32). Therefore, the cumulative register is decreased by \$40, and zero remains in the cumulative register (\$40 - \$40).

(E) \* \* \*

(2) For Year 2, the P group computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group determines its ability to use its capital loss carryover before it determines its ability to use its ordinary loss carryover. Under section 1212, because the P group has no Year 2 capital gain, it cannot absorb any capital losses in Year 2. T's Year 1 net capital loss and the P group's Year 2 consolidated net capital loss (all of which is attributable to T) are carried over to Year 3.

(3) The P group's ability to deduct net operating losses in Year 2 is subject to the 80-percent limitation, based on the P group's consolidated taxable income for the year. Thus, the group's limitation for Year 2 is \$72 (\$90 x 80 percent). However, use of the Year 1 net operating loss also is subject to the SRLY limitation. The positive balance of the cumulative register of T applicable to SRLY net operating losses for Year 2 equals the P group's consolidated taxable income determined by reference to only T's items, or \$60. Under paragraph (c)(1)(i)(E) of this section, after taking into account the 80-percent limitation, the SRLY limitation for Year 2 is \$48 (\$60 x 80 percent). Therefore, only \$48 of T's Year 1 SRLY

net operating loss is absorbed by the P group in Year 2. T carries over its remaining \$52 of its Year 1 loss to Year 3.

(4) After deduction of T's SRLY net operating losses in Year 2, the net operating loss cumulative register is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. The P group deducted \$48 of T's SRLY net operating losses in Year 2. After taking into account the 80-percent limitation, the amount of taxable income necessary to support this deduction is \$60 (\$60 x 80 percent = \$48). Therefore, the net operating loss cumulative register of T is decreased by \$60, and zero remains in the net operating loss cumulative register (\$60 - \$60).

(5) For Year 3, the P group again computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group has consolidated net capital gain (without taking into account a net capital loss carryover deduction) of \$30. Under §1.1502-22(c), the aggregate amount of T's \$50 capital loss carryover from Year 1 that is included in computing the P group's consolidated net capital gain for all years of the group (in this case, Years 2 and 3) may not exceed \$30 (the aggregate consolidated net capital gain computed by reference only to T's items, including losses and deductions actually absorbed (that is, \$30 of capital gain in Year 3)). Thus, the P group may include \$30 of T's Year 1 capital loss carryover in its computation of consolidated net capital gain for Year 3, which offsets the group's capital gains for Year 3. T carries over its remaining \$20 of its Year 1 capital loss to Year 4. Therefore, the capital loss cumulative register of T is decreased by \$30, and zero remains in the capital loss cumulative register (\$30 - \$30). Further, because the net operating loss cumulative register includes all taxable income of T included in the P group, as well as all absorbed losses of T (including capital items), a zero net increase occurs in the net operating loss cumulative register. The P group carries over the Year 2 consolidated net capital loss to Year 4.

(6) The P group's ability to deduct net operating losses in Year 3 is subject to the 80-percent limitation, based on the P group's consolidated taxable income for the year. Thus, the P group's taxable income for Year 3 that can be offset, before use of net operating losses, is \$40 (80 percent x the sum of zero capital gain, after use of the capital loss carryover, plus \$50 of ordinary income). However, use of the Year 1 net operating loss also is subject to the SRLY limitation. The positive balance of the cumulative register of T applicable to SRLY net operating losses for Year 3 equals the P group's consolidated taxable income determined by reference only to T's items, or \$40. This amount equals the sum obtained by adding the zero carryover from Year 2, a net inclusion of zero from capital items implicated in Year 3 (\$30 - \$30), and \$40 of taxable income in Year 3. Under paragraph (c)(1)(i)(E) of this section, after taking into account the 80-percent limitation, the SRLY limitation for Year 3 is \$32 (\$40 x 80 percent). Therefore, only \$32 of the Year 1 net operating loss is absorbed by the P group in Year 3. T carries over its remaining \$20 of its Year 1 loss to Year 4.

(F) *Example 6: Pre-2018 NOLs and post-2017 NOLs.* (1) Individual A owns P. On January 1, 2017, A forms T. P and T are calendar-year taxpayers. In 2017, T sustains a \$100 net operating loss that is carried over. During 2018, 2019, and 2020, T deducts a

total of \$90 of its 2017 net operating loss against its taxable income, and T carries over the remaining \$10 of its 2017 net operating loss. In 2021, T sustains a net operating loss of \$50. On December 31, 2021, P acquires all the stock of T, and T becomes a member of the P group. The P group has \$300 of consolidated taxable income in 2022 (computed without regard to the CNOL deduction). Such consolidated taxable income would be \$70 if determined by reference to only T's items. The P group has no other SRLY net operating loss carryovers or CNOL carryovers.

(2) T's remaining \$10 of net operating loss carry-over from 2017 and its \$50 net operating loss carry-over from 2021 are both SRLY losses in the P group. See §1.1502-1(f)(2)(iii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, T's net operating loss carryovers are subject to the SRLY limitation in paragraph (c)(1) of this section. The SRLY limitation for the P group's 2022 consolidated return year is consolidated taxable income determined by reference to only T's items, or \$70.

(3) Because T's oldest (2017) carryover was sustained in a year beginning before January 1, 2018, its use is not subject to limitation under section 172(a)(2)(B). Therefore, all \$10 of T's 2017 SRLY net operating loss (that is, a pre-2018 NOL) is included under paragraph (a) of this section in the P group's CNOL deduction for 2022. After deduction of T's \$10 SRLY net operating loss from 2017, the cumulative register of T is reduced on a dollar-for-dollar basis, pursuant to paragraph (c)(1)(i) of this section. Therefore, the cumulative register of T is decreased by \$10, and \$60 remains in the cumulative register (\$70 - \$10).

(4) The P group's deduction of T's 2021 net operating loss is subject to both a SRLY limitation and the 80-percent limitation under section 172(a)(2)(B). Therefore, the total limitation on the use of T's 2021 net operating loss in the P group is \$48 (the remaining cumulative register of \$60 x 80 percent). No losses from equivalent years are available, and the P group otherwise has sufficient consolidated taxable income to support the CNOL deduction (\$290 x 80 percent = \$232). Therefore, \$48 of T's 2021 SRLY net operating loss is included under paragraph (a) of this section in the P group's CNOL deduction for 2022. The remaining \$2 of T's 2021 SRLY net operating loss (\$50 - \$48) is carried over to the P group's 2023 consolidated return year.

(5) After deduction of T's \$48 SRLY NOL in 2022, the cumulative register of T is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. After taking into account the 80-percent limitation, the amount of income necessary to support this deduction is \$60 (\$60 x 80 percent = \$48). Therefore, the cumulative register of T is decreased by \$60, and zero remains in the cumulative register (\$60 - \$60).

(2) \* \* \*

(v) *Coordination with other limitations.* This paragraph (c)(2) does not allow a net operating loss to offset income to the extent inconsistent with other limitations or restrictions on the use of losses, such as a limitation based on the nature or activities of members. For example, a net operating loss may not offset income in excess of any limitations under section

172(a) and paragraph (a)(2) of this section. Additionally, any dual consolidated loss may not reduce the taxable income to an extent greater than that allowed under section 1503(d) and §§ 1.1503(d)-1 through 1.1503(d)-8. See also § 1.1502-47(k) (relating to preemption of rules for life-nonlife groups).

\* \* \* \*

(viii) \* \* \* For purposes of the examples in this paragraph (c)(2)(viii), no corporation is a nonlife insurance company or has any farming losses. \* \* \*

\* \* \* \*

(B) \* \* \*

(3) In Year 4, the M group has \$10 of consolidated taxable income (computed without regard to the CNOL deduction for Year 4). That consolidated taxable income would be \$45 if determined by reference only to the items of P, S, and T, the members included in the SRLY subgroup with respect to P's loss carryover. Therefore, the positive balance of the cumulative register of the P SRLY subgroup for Year 4 equals \$45 and, due to the application of the 80-percent limitation under paragraph (c)(2)(v) of this section, the SRLY subgroup limitation under this paragraph (c)(2) is \$36 (\$45 x 80 percent). However, the M group has only \$10 of consolidated taxable income in Year 4. Thus, due to the 80-percent limitation and the application of paragraph (b)(1) of this section, the M group's deduction of all net operating losses in Year 4 is limited to \$8 (\$10 x 80 percent). As a result, the M group deducts \$8 of P's SRLY net operating loss carryover, and the remaining \$37 is carried over to Year 5.

(4) After deduction of \$8 of P's SRLY net operating loss in Year 4, the cumulative register of the P SRLY subgroup is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. After taking into account the 80-percent limitation, the amount of income necessary to support this deduction is \$10 (\$10 x 80 percent = \$8). Therefore, the cumulative register of the P SRLY subgroup is decreased by \$10, and \$35 remains in the cumulative register (\$45 - \$10).

(5) In Year 5, the M group has \$100 of consolidated taxable income (computed without regard to the CNOL deduction for Year 5). None of P, S, or T has any items of income, gain, deduction, or loss in Year 5. Although the members of the P SRLY subgroup do not contribute to the \$100 of consolidated taxable income in Year 5, the positive balance of the cumulative register of the P SRLY subgroup for Year 5 is \$35 and, due to the application of the 80-percent limitation under paragraph (c)(2)(v) of this section, the SRLY subgroup limitation under this paragraph (c)(2) is \$28 (\$35 x 80 percent). Because of the 80-percent limitation and the application of paragraph (b)(1) of this section, the M group's deduction of net operating losses in Year 5 is limited to \$80 (\$100 x 80 percent). Because the \$28 of net operating loss available to be absorbed is less than 80 percent of the M group's consolidated taxable income, \$28 of P's SRLY net operating loss is absorbed in Year 5, and the remaining \$9 (\$37 - \$28) is carried over to Year 6.

(6) After deduction of \$28 of P's SRLY net operating loss in Year 5, the cumulative register of the

P SRLY subgroup is adjusted pursuant to paragraph (c)(1)(i)(E) of this section. After taking into account the 80-percent limitation, the amount of income necessary to support this deduction is \$35 (\$35 x 80 percent = \$28). Therefore, the cumulative register of the P SRLY subgroup is decreased by \$35, and zero remains in the cumulative register (\$35 - \$35).

\* \* \* \*

(h) \* \* \*

(9) [The text of proposed §1.1502-21(h)(9) is the same as the text of §1.1502-21T(h)(9) published elsewhere in this issue of the **Federal Register**.]

(10) The rules of paragraphs (a), (b)(1), (b)(2)(iv), and (c)(1)(i)(E) of this section apply to losses arising in taxable years beginning after [the date the Treasury decision adopting these rules as final regulations is published in the **Federal Register**].

Par. 4. Section 1.1502-47 is amended by:

1. Revising paragraphs (a)(2)(i) and (ii).
2. Removing paragraph (a)(3).
3. Redesignating paragraph (a)(4) as paragraph (a)(3).
4. Removing paragraph (j).
5. Redesignating paragraph (n) as paragraph (j).
6. Redesignating paragraph (b) as paragraph (n).
7. Redesignating paragraph (t) as paragraph (n)(3).
8. Removing paragraph (c).
9. Redesignating paragraph (d) as paragraph (b).
10. Revising newly redesignated paragraph (b)(1).
11. Removing newly redesigned paragraph (b)(2).
12. Redesignating newly redesigned paragraphs (b)(3) through (14) as paragraphs (b)(2) through (13), respectively.
13. Revising newly redesigned paragraphs (b)(2), (3), (4), (9), (10), and (12).
14. In newly redesigned paragraph (b)(13), designating *Examples 1* through *14* as paragraphs (b)(13)(i) through (xiv), respectively.
15. In newly redesigned paragraph (b)(13)(i), adding a new last sentence.
16. Revising newly redesigned paragraph (b)(13)(ii).
17. Removing newly redesigned paragraph (b)(13)(xiv).
18. Redesignating paragraph (e) as paragraph (c).

19. Removing newly redesigned paragraphs (c)(4) and (5).

20. Redesignating paragraph (c)(6) as paragraph (c)(4).

21. Redesignating paragraph (f) as paragraph (d).

22. Revising newly redesigned paragraph (d)(5).

23. Removing the last sentence of newly redesigned paragraph (d)(6).

24. Removing newly redesigned paragraph (d)(7)(ii).

25. Redesignating paragraph (d)(7)(iii) as paragraph (d)(7)(ii) and revising it.

26. Redesignating paragraph (g) as paragraph (e).

27. In newly redesigned paragraph (e)(2), removing the language "partial" each place it appears.

28. Removing newly redesigned paragraph (e)(3).

29. Redesignating paragraph (h) as paragraph (f).

30. Revising newly redesigned paragraph (f)(2)(iii).

31. In newly designated paragraph (f)(2)(v), removing the language "partial" each place it appears.

32. In newly designated paragraph (f)(2)(v), adding a new last sentence.

33. Revising newly designated paragraph (f)(2)(vi) and (vii).

34. Removing newly designated paragraph (f)(3).

35. Redesignating newly designated paragraph (f)(4) as paragraph (f)(3).

36. Revising newly redesigned paragraph (f)(3)(ii).

37. Adding a new paragraph (g).

38. Redesignating paragraph (k)(5) introductory text as paragraph (g)(3)(ii), and redesignating paragraphs (k)(5)(i) through (iv) as paragraphs (g)(3)(ii)(A) through (D), respectively.

39. Removing newly redesigned paragraphs (g)(3)(ii)(C) and (D).

40. Removing paragraphs (k) and (l).

41. Redesignating paragraph (m) as paragraph (h).

42. In newly redesigned paragraph (h), removing the language "partial" each place it appears.

43. In newly redesigned paragraph (h)(2)(ii), adding a new last sentence.

44. In newly redesigned paragraph (h)(3)(iv), adding a new last sentence.

45. In newly redesignated paragraph (h)(3)(ix), removing the last two sentences.
46. Removing newly redesignated paragraph (h)(4).
47. Redesignating newly redesignated paragraph (h)(5) as paragraph (h)(4).
48. Revising newly redesignated paragraph (h)(4) introductory text.
49. In newly redesignated paragraph (h)(4), redesignating *Examples 1* through 6 as paragraphs (h)(4)(i) through (vi).
50. Revising newly designated paragraphs (h)(4)(ii) and (iii).
51. Removing newly designated paragraphs (h)(4)(v) and (vi).
52. In newly redesignated paragraph (j)(2)(iii), removing the language “, and “section 812(b)(3)” and adding in its place “section 172(b)(3)(C)”.
53. Removing newly redesignated paragraph (j)(2)(v).
54. Redesignating newly redesignated paragraph (j)(2)(vi) as paragraph (j)(2)(v).
55. Revising newly redesignated paragraph (j)(3).
56. In newly redesignated paragraph (n)(3), removing the language “Effective/applicability date” and adding the language “Filing requirements effective dates” in its place.
57. Adding paragraph (n)(4).
58. Removing paragraphs (o) and (p).
59. Redesignating paragraphs (q), (r), and (s) as paragraphs (k), (l), and (m), respectively.
59. In the following table, for each section designated or redesignated under these proposed regulations (as indicated in the second column), removing the language in the third column and adding the language in the fourth column with the frequency indicated in the fifth column:

<b>Paragraph</b>	<b>Redesignation</b>	<b>Remove</b>	<b>Add</b>	<b>Frequency</b>
1.1502-47(a)(1)	N/A	section 802 or 821 (relating respectively to life insurance companies and to certain mutual insurance companies)	section 801 (relating to life insurance companies)	Once
1.1502-47(a)(1)	N/A	life insurance companies and mutual insurance companies may	life insurance companies may	Once
1.1502-47(a)(1)	N/A	composition and its consolidated tax	composition, its consolidated taxable income (or loss), and its consolidated tax	Once
1.1502-47(a)(4)	1.1502-47(a)(3)	§§ 1.1502-1 through 1.1502-80	§§ 1.1502-0 through 1.1502-100	Once
1.1502-47(a)(4)	1.1502-47(a)(3)	844	848	Once
1.1502-47(b)	1.1502-47(n)	Effective dates	Effective/applicability dates	Once
1.1502-47(b)(1)	1.1502-47(n)(1)	paragraph (b)(2)	paragraph (n)(2) and (3)	Once
1.1502-47(b)(2)(i)	1.1502-47(n)(2)(i)	Paragraph (d)(12)(v)	Paragraph (b)(11)(v)	Once
1.1502-47(d)(12)(i)(A), (d)(12)(i)(C), (d)(12)(i)(D), (d)(12)(iii), (d)(12)(iv), (d)(12)(v), (d)(12)(v)(B), (d)(12)(v)(C), (d)(12)(v)(D), (d)(12)(vi), (d)(12)(vii), and (d)(12)(viii)(F)	1.1502-47(b)(11)(i)(A), (b)(11)(i)(C), (b)(11)(i)(D), (b)(11)(iii), (b)(11)(iv), (b)(11)(v), (b)(11)(v)(B), (b)(11)(v)(C), (b)(11)(v)(D), (b)(11)(vi), (b)(11)(vii), and (b)(11)(viii)(F), respectively	(d)(12)	(b)(11)	Each place it appears
1.1502-47(d)(12)(iii)	1.1502-47(b)(11)(iii)	subdivision (iii)	paragraph (b)(11)(iii)	Once
1.1502-47(d)(12)(iv)	1.1502-47(b)(11)(iv)	subdivision (iv)	paragraph (b)(11)(iv)	Once
1.1502-47(d)(12)(v)(B)	1.1502-47(b)(11)(v)(B)	(i.e., sections 11, 802, 821, or 831)	(for example, section 11, section 801, or section 831)	Once
1.1502-47(d)(12)(vi)	1.1502-47(b)(11)(vi)	subdivision (vi)	paragraph (b)(11)(vi)	Once
1.1502-47(d)(12)(vii)	1.1502-47(b)(11)(vii)	return year and even	return year even	Once

<b>Paragraph</b>	<b>Redesignation</b>	<b>Remove</b>	<b>Add</b>	<b>Frequency</b>
1.1502-47(d)(12)(viii)(A)	1.1502-47(b)(11)(viii)(A)	(i.e., total reserves in section 801(c))	(that is, total reserves in section 816(c), as modified by section 816(h))	Once
1.1502-47(d)(12)(viii)(D) and (F)	1.1502-47(b)(11)(viii)(D) and (F), respectively	subdivision (viii)	paragraph (b)(11)(viii)	Once
1.1502-47(d)(14)	1.1502-47(b)(13)	<i>Illustrations</i>	<i>Examples</i>	Once
1.1502-47(d)(14)	1.1502-47(b)(13)	paragraph (d)	paragraph (b)	Once
1.1502-47(d)(14), Example 1	1.1502-47(b)(13)(i)	1913	2012	Once
1.1502-47(d)(14), Examples 2 through 4, 8, 10, and 12	1.1502-47(b)(13)(ii) through (iv), (viii), (x), and (xii), respectively	1974	2012	Each place it appears
1.1502-47(d)(14), Examples 1 through 3	1.1502-47(b)(13)(i) through (iii), respectively	1980	2018	Each place it appears
1.1502-47(d)(14), Examples 1 through 5 and 8 through 13	1.1502-47(b)(13)(i) through (v) and (viii) through (xiii), respectively	1982	2020	Each place it appears
1.1502-47(d)(14), Examples 5 through 7 and 9	1.1502-47(b)(13)(v) through (vii) and (ix), respectively	1983	2021	Each place it appears
1.1502-47(d)(14), Examples 2 through 5 and 8 through 12	1.1502-47(b)(13)(ii) through (v) and (viii) through (xii), respectively	(d)(12)	(b)(11)	Each place it appears
1.1502-47(d)(14), Examples 2, 3, and 12	1.1502-47(b)(13)(ii), (iii), and (xii), respectively	stock casualty	nonlife insurance	Each place it appears
1.1502-47(d)(14), Example 3	1.1502-47(b)(13)(iii)	subparagraph (d)(12)(v) (B) and (E)	paragraph (b)(11)(v)(B) and (D)	Once
1.1502-47(d)(14), Example 3	1.1502-47(b)(13)(iii)	e.g.	for example	Once
1.1502-47(d)(14), Example 5	1.1502-47(b)(13)(v)	i.e.	in other words	Once
1.1502-47(d)(14), Example 12	1.1502-47(b)(13)(xii)	casualty	nonlife insurance	Once
1.1502-47(e)(1)	1.1502-47(c)(1)	life company or an ineligible mutual company.	life company.	Once
1.1502-47(e)(3)	1.1502-47(c)(3)	§ 1.1502-75(c) and paragraph (e)(4) of this section,	§ 1.1502-75(c),	Once
1.1502-47(f)(3)	1.1502-47(d)(3)	1981	2019	Each place it appears
1.1502-47(f)(3)	1.1502-47(d)(3)	1982	2020	Each place it appears
1.1502-47(f)(3)	1.1502-47(d)(3)	applying §§ 1.1502-13, 1.1502-18, and 1.1502-19	applying §§ 1.1502-13 and 1.1502-19	Once
1.1502-47(f)(7)(i)	1.1502-47(d)(7)(i)	paragraph (g)	paragraph (e)	Once
1.1502-47(f)(7)(i)	1.1502-47(d)(7)(i)	sections 802(a), 821(a), and 831(a)	sections 801(a) and 831(a)	Once
1.1502-47(g)	1.1502-47(e)	three	two	Once

<b>Paragraph</b>	<b>Redesignation</b>	<b>Remove</b>	<b>Add</b>	<b>Frequency</b>
1.1502-47(g)(1)	1.1502-47(e)(1)	paragraph (h)	paragraph (f)	Once
1.1502-47(g)(1)	1.1502-47(e)(1)	paragraph (n)	paragraph (j)	Once
1.1502-47(g)(1)	1.1502-47(e)(1)	paragraph (g)(1)	paragraph (e)(1)	Once
1.1502-47(g)(2)	1.1502-47(e)(2)	paragraph (j)	paragraph (g)(1)	Once
1.1502-47(g)(2)	1.1502-47(e)(2)	paragraph (m)	paragraph (h)	Once
1.1502-47(g)(2)	1.1502-47(e)(2)	paragraph (g)(2)	paragraph (e)(2)	Once
1.1502-47(h)(1)	1.1502-47(f)(1)	paragraph (h)	paragraph (f)	Once
1.1502-47(h)(1)	1.1502-47(f)(1)	includes separate mutual insurance company taxable income (as defined in section 821(b)) and insurance company taxable income	includes insurance company taxable income	Once
1.1502-47(h)(2)(i)	1.1502-47(f)(2)(i)	§§ 1.1502-21 or 1.1502-21A (as appropriate), the rules in this subparagraph (2)	§1.1502-21, the rules in this paragraph (f)(2)	Once
1.1502-47(h)(2)(ii)	1.1502-47(f)(2)(ii)	§§ 1.1502-21(A)(f) or 1.1502-21(e) (as appropriate)	§1.1502-21(e)	Once
1.1502-47(h)(2)(iv)	1.1502-47(f)(2)(iv)	year beginning after December 31, 1981, §§ 1.1502-21A or 1.1502-21 (as appropriate)	year, §1.1502-21	Once
1.1502-47(h)(2)(iv)	1.1502-47(f)(2)(iv)	nonlife loss	nonlife subgroup loss	Once
1.1502-47(h)(2)(v)	1.1502-47(f)(2)(v)	subparagraph (2)	paragraph (f)(2)	Once
1.1502-47(h)(4)(i)	1.1502-47(f)(3)(i)	§§ 1.1502-22 or 1.1502-22A (as appropriate)	§1.1502-22	Once
1.1502-47(h)(4)(i)	1.1502-47(f)(3)(i)	subparagraph (4)	paragraph (f)(3)	Once
1.1502-47(h)(4)(i)	1.1502-47(f)(3)(i)	§§ 1.1502-22 or 1.1502-22A(a) (as appropriate)	§1.1502-22	Once
1.1502-47(h)(4)(iii)	1.1502-47(f)(3)(iii)	§§ 1.1502-22A(b)(1) or 1.1502-22(b)	§1.1502-22(b),	Once
1.1502-47(h)(4)(iii)(A)	1.1502-47(f)(3)(iii)(A)	allowed under section 822(c)(6) or section 832(c)(5),	allowed under section 832(c)(5),	Once
1.1502-47(k)(5)	1.1502-47(g)(3)(ii)	§ § 1.1502-22 or 1.1502-22A (as appropriate)	§1.1502-22	Once
1.1502-47(k)(5)	1.1502-47(g)(3)(ii)	this subparagraph (5)	this paragraph (g)(3)(ii)	Once
1.1502-47(k)(5)(ii)	1.1502-47(g)(3)(ii)(B)	paragraph (k)(5)	paragraph (g)(3)(ii)	Once
1.1502-47(m)	1.1502-47(h)	paragraph (g)	paragraph (e)	Each place it appears
1.1502-47(m)	1.1502-47(h)	paragraph (h)	paragraph (f)	Each place it appears

<b>Paragraph</b>	<b>Redesignation</b>	<b>Remove</b>	<b>Add</b>	<b>Frequency</b>
1.1502-47(m)	1.1502-47(h)	paragraph (l)	paragraph (g)	Each place it appears
1.1502-47(m)	1.1502-47(h)	paragraph (m)	paragraph (h)	Each place it appears
1.1502-47(m)(2)(ii)	1.1502-47(h)(2)(ii)	§§ 1502-21 or 1.1502-21A (as appropriate)	§1.1502-21	Once
1.1502-47(m)(2)(ii)	1.1502-47(h)(2)(ii)	§§ 1.1502-22 or 1.1502-22A (as appropriate)	§1.1502-22	Once
1.1502-47(m)(3)(i)	1.1502-47(h)(3)(i)	But see subdivision (ix) of this paragraph (m)(3)	But see paragraph (h)(3) (ix) of this section	Once
1.1502-47(m)(3)(i)	1.1502-47(h)(3)(i)	arising in separate return years ending after December 31, 1980,	arising in separate return years	Once
1.1502-47(m)(3)(i)	1.1502-47(h)(3)(i)	and 1.1502-22 (or §§ 1.1502-21A and 1.1502-22A, as appropriate).	and 1.1502-22.	Once
1.1502-47(m)(3)(iii)	1.1502-47(h)(3)(iii)	consolidated LO	life consolidated net operating loss	Once
1.1502-47(m)(3)(v)	1.1502-47(h)(3)(v)	GO or TII	taxable income	Once
1.1502-47(m)(3)(v)	1.1502-47(h)(3)(v)	LICTI (as determined under paragraph (j) of this section) for any	LICTI for any	Once
1.1502-47(m)(3)(vi)(A)	1.1502-47(h)(3)(vi)(A)	subparagraph (3)	paragraph (h)(3)	Once
1.1502-47(m)(3)(vii)(A)	1.1502-47(h)(3)(vii)(A)	notwithstanding § 1.1502-21A(b)(3)(ii) or 1.1502-21(b),	notwithstanding §1.1502-21(b),	Once
1.1502-47(m)(3)(vii)(A)	1.1502-47(h)(3)(vii)(A)	taxable income for that year.	taxable income for that year, subject to the limitation in section 172(a).	Once
1.1502-47(m)(3)(vii)(B)	1.1502-47(h)(3)(vii)(B)	(A) of this subdivision (vii)	paragraph (h)(3)(vii)(A) of this section	Once
1.1502-47(m)(3)(viii)	1.1502-47(h)(3)(viii)	section 172(b)(3)(C)	section 172(b)(3)	Once
1.1502-47(m)(3)(ix)	1.1502-47(h)(3)(ix)	243(b)(2)	243(b)(3)	Once
1.1502-47(m)(3)(ix)	1.1502-47(h)(3)(ix)	return year ending after December 31, 1980,	return year,	Once
1.1502-47(m)(3)(x)	1.1502-47(h)(3)(x)	LICTI (as defined in paragraph (j) of this section) in the particular	LICTI in the particular	Once
1.1502-47(m)(3)(xii)	1.1502-47(h)(3)(xii)	carryback of a consolidated LO	carryback of a life consolidated net operating loss	Once
1.1502-47(m)(3)(xii)	1.1502-47(h)(3)(xii)	(2) or (4)	(2) or (3)	Once
1.1502-47(m)(5), Examples 1 through 4	1.1502-47(h)(4)(i) through (iv), respectively	1982	2021	Each place it appears
1.1502-47(m)(5), Examples 1 through 4	1.1502-47(h)(4)(i) through (iv), respectively	i.e.	that is	Each place it appears

<b>Paragraph</b>	<b>Redesignation</b>	<b>Remove</b>	<b>Add</b>	<b>Frequency</b>
1.1502-47(m)(5), Example 1	1.1502-47(h)(4)(i)	paragraph (d)(13)	paragraph (b)(12)	Once
1.1502-47(m)(5), Example 1	1.1502-47(h)(4)(i)	attributable to I (an ineligible member)	attributable to I (an ineligible member that is not a nonlife insurance company)	Once
1.1502-47(m)(5), Example 1	1.1502-47(h)(4)(i)	of this section. The result would be	of this section and section 172(a). The result would be	Once
1.1502-47(m)(5), Example 4	1.1502-47(h)(4)(iv)	of this section or under § 1.1502-15A.	of this section.	Once
1.1502-47(m)(5), Example 4	1.1502-47(h)(4)(iv)	taxable income is \$35	taxable income is \$32.5	Once
1.1502-47(m)(5), Example 4	1.1502-47(h)(4)(iv)	30%	35%	Once
1.1502-47(m)(5), Example 4	1.1502-47(h)(4)(iv)	(15)	(17.5)	Once
1.1502-47(m)(5), Example 4	1.1502-47(h)(4)(iv)	(65)	(67.5)	Once
1.1502-47(m)(5), Example 4	1.1502-47(h)(4)(iv)	(85)	(82.5)	Once
1.1502-47(n)	1.1502-47(j)	consolidated LO	life consolidated net operating loss and consolidated operations loss carryovers	Each place it appears
1.1502-47(n)(1)	1.1502-47(j)(1)	paragraph (g)(1)	paragraph (e)(1)	Once
1.1502-47(n)(1)	1.1502-47(j)(1)	paragraph (n)(2) of this section	paragraph (j)(2) of this section, subject to the rules and limitations in paragraph (j)(3) of this section	Once
1.1502-47(n)(1)	1.1502-47(j)(1)	consolidated net capital loss (as determined under paragraph (l)(4) of this section).	consolidated net capital loss.	Once
1.1502-47(n)(2)	1.1502-47(j)(2)	paragraph (h)	paragraph (f)	Once
1.1502-47(n)(2)	1.1502-47(j)(2)	paragraphs (m)(2) and (3)	paragraphs (h)(2) and (3)	Once
1.1502-47(n)(2)(ii)	1.1502-47(j)(2)(ii)	consolidated partial LICTI	consolidated LICTI	Once
1.1502-47(n)(2)(iii)	1.1502-47(j)(2)(iii)	“paragraph (l)” or “paragraph (j)”	“paragraph (g)”	Once
1.1502-47(n)(2)(iii)	1.1502-47(j)(2)(iii)	paragraph (h)	paragraph (f)	Once
1.1502-47(n)(2)(iv)	1.1502-47(j)(2)(iv)	Paragraphs (m)(3)(vi), (vii), (x), and (xi)	Paragraphs (h)(3)(vi), (vii), (x), and (xi)	Once
1.1502-47(q)	1.1502-47(k)	1.1502-80	1.1502-100	Once
1.1502-47(q)	1.1502-47(k)	paragraph (m)(3)(vi)	paragraph (h)(3)(vi)	Once

Paragraph	Redesignation	Remove	Add	Frequency
1.1502-47(q)	1.1502-47(k)	§§ 1.1502-21A(b)(3) and 1.1502-79A(a)(3) (or § 1.1502-21, as appropriate)	§1.1502-21	Once
1.1502-47(r)	1.1502-47(l)	partial LICTI (or LO)	LICTI (or life consolidated net operating loss)	Once
1.1502-47(r)	1.1502-47(l)	§§ 1.1502-0 - 1.1502-80	§§ 1.1502-0 through 1.1502-100	Once
1.1502-47(s)(1)(iii)	1.1502-47(m)(1)(iii)	paragraphs (g), (m), and (n)	paragraphs (e), (h), and (j)	Once
1.1502-47(s)(1)(iv)	1.1502-47(m)(1)(iv)	paragraph (h)	paragraph (f)	Once
1.1502-47(s)(1)(v)	1.1502-47(m)(1)(v)	consolidated partial Life	consolidated Life	Once
1.1502-47(s)(1)(v)	1.1502-47(m)(1)(v)	(as defined by paragraph (d)(3) of this section), determined under paragraph (j) of this section,	or life consolidated net operating loss	Once
1.1502-47(t)	1.1502-47(n)(3)	Paragraph (s)	Paragraph (m)	Once
1.1502-47(t)	1.1502-47(n)(3)	paragraph (s)	paragraph (m)	Once

The additions and revisions read as follows:

*§1.1502-47 Consolidated returns by life-nonlife groups.*

(a) \* \* \*

(2) *General method of consolidation—*  
(i) *Subgroup method.* The regulations adopt a subgroup method to determine consolidated taxable income. One subgroup is the group's nonlife companies. The other subgroup is the group's life insurance companies. Initially, the nonlife subgroup computes nonlife consolidated taxable income and the life subgroup computes consolidated LICTI. A subgroup's income may in effect be reduced by a loss of the other subgroup, subject to the limitations in sections 172 and 1503(c). The life subgroup losses consist of life consolidated net operating loss, consolidated operations loss carryovers from taxable years beginning before January 1, 2018 (consolidated operations loss carryovers), and life consolidated net capital loss. The nonlife subgroup losses consist of nonlife consolidated net operating loss and non-life consolidated net capital loss. Consolidated taxable income is therefore defined in pertinent part as the sum of nonlife consolidated taxable income and consolidated

LICTI, reduced by life subgroup losses and/or nonlife subgroup losses.

(ii) *Subgroup loss.* A subgroup loss does not actually affect the computation of nonlife consolidated taxable income or consolidated LICTI. It merely constitutes a bottom-line adjustment in reaching consolidated taxable income. Furthermore, the amount of a subgroup's loss, if any, that is eligible to be carried back to a prior taxable year first must be carried back against income of the same subgroup before it may be used as a setoff against the other subgroup's income in the taxable year the loss arose. (See sections 172(b)(1) and 1503(c)(1); see also §1.1502-21(b)). The carryback of losses from one subgroup may not be used to offset income of the other subgroup in the year to which the loss is to be carried. This carryback of one subgroup's loss may "bump" the other subgroup's loss that, in effect, previously reduced the income of the first subgroup. The subgroup's loss that is bumped in appropriate cases may, in effect, reduce a succeeding year's income of either subgroup. This approach gives the group the tax savings of the use of losses, but the bumping rule assures that, insofar as possible, life deductions will be matched

against life income and nonlife deductions against nonlife income.

\* \* \* \* \*

(b) \* \* \*

(1) *Life company.* The term *life company* means a life insurance company as defined in section 816 and subject to tax under section 801. Section 816 applies to each company separately.

(2) *Life insurance company taxable income.* The term *life insurance company taxable income* or *LICTI* has the meaning provided in section 801(b).

(3) *Group.* The term *group* has the meaning provided in §1.1502-1(a). Unless otherwise indicated in this section, a group's composition is determined without regard to section 1504(b)(2).

(4) *Member.* The term *member* has the meaning provided in §1.1502-1(b). A life company is tentatively treated as a member for any taxable year for purposes of determining if it is an eligible corporation under paragraph (b)(10) of this section and, therefore, if it is an includable corporation under section 1504(c)(2). If such a company is eligible and includable (under section 1504(c)(2)), it will actually be treated as a member of the group.

\* \* \* \* \*

(9) *Separate return year.* The term *separate return year* has the meaning provided in §1.1502-1(e). For purposes of this paragraph (b)(9), the term *group* is defined with regard to section 1504(b)(2) for years in which an election under section 1504(c)(2) is not in effect. Thus, a separate return year includes a taxable year for which that election is not in effect.

(10) *Separate return limitation year.* Section 1.1502-1(f)(2) provides exceptions to the definition of the term *separate return limitation year*. For purposes of applying those exceptions to this section, the term *group* is defined without regard to section 1504(b)(2), and the definition in this paragraph (b)(10) applies separately to the nonlife subgroup in determining nonlife consolidated taxable income under paragraph (f) of this section and to the life subgroup in determining consolidated LICTI under paragraph (g) of this section. Paragraph (h)(3)(ix) of this section defines the term *separate return limitation year* for purposes of determining whether the losses of one subgroup may be used against the income of the other subgroup.

\* \* \* \* \*

(12) *Ineligible corporation.* A corporation that is not an eligible corporation is ineligible. If a life company is ineligible, it is not treated under section 1504(c)(2) as an includible corporation. Losses of a nonlife member arising in years when it is ineligible may not be used under section 1503(c)(2) and paragraph (g) of this section to set off the income of a life member. If a life company is ineligible and is the common parent of the group (without regard to section 1504(b)(2)), the election under section 1504(c)(2) may not be made.

(13) \* \* \*

(i) \* \* \* S<sub>2</sub> must file its own separate return for 2020.

(ii) *Example 2.* Since 2012, L1 has been a life company owning all the stock of L2. In 2018, L1 transfers assets to S1, a new nonlife insurance company subject to taxation under section 831(a). For 2020, only L1 and L2 are eligible corporations. The tacking rule in paragraph (b)(11)(v) of this section does not apply in 2020 because the old corporation (L1) and the new corporation (S1) do not have the same tax character.

\* \* \* \* \*

(d) \* \* \*

\* \* \* \* \*

(5) *Dividends received deduction—(i) Dividends received by insurance com-*

*pany.* Dividends received by an eligible member insurance company, taxed under either section 801 or section 831, from another eligible member of the group are treated for Federal income tax purposes as if the group did not file a consolidated return. See sections 818(e)(2) and 805(a)(4) for rules regarding a member taxed under section 801, and see sections 832(g) and 832(b)(5)(B) through (E) for rules regarding a member taxed under section 831.

(ii) *Other dividends.* Dividends received from a life company member of the group that are not subject to paragraph (d)(5)(i) of this section are not included in gross income of the distributee member. See section 1504(c)(2)(B)(i). If the distributee corporation is a nonlife insurance company subject to tax under section 831, the rules of section 832(b)(5)(E) apply.

\* \* \* \* \*

(7) \* \* \*

(ii) Any taxes described in §1.1502-2 (other than in §1.1502-2(a)(1), (a)(6), and (a)(7)).

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(iii) *Carrybacks.* The portion of the nonlife consolidated net operating loss for the nonlife subgroup described in paragraph (f)(2)(vi) of this section, if any, that is eligible to be carried back to prior taxable years under §1.1502-21 is carried back to the appropriate years (whether consolidated or separate) before the nonlife consolidated net operating loss may be used as a nonlife subgroup loss under paragraphs (e)(2) and (h) of this section to set off consolidated LICTI in the year the loss arose. The election under section 172(b)(3) to relinquish the entire carryback period for the net operating loss of the nonlife subgroup may be made by the agent for the group within the meaning of §1.1502-77.

(v) \* \* \* For limitations on the use of nonlife carryovers to offset nonlife consolidated taxable income or consolidated LICTI, see §1.1502-21(a).

(vi) *Portion of nonlife consolidated net operating loss that is carried back to prior taxable years.* The portion of the nonlife consolidated net operating loss that (absent an election to waive carrybacks) is carried back to the two preceding taxable years is the sum of the nonlife subgroup's farming loss (within the meaning of sec-

tion 172(B)(1)(b)(ii)) and the amount of the subgroup's net operating loss that is attributable to nonlife insurance companies (as determined under §1.1502-21). For rules governing the absorption of net operating loss carrybacks, including limitations on the amount of net operating loss carrybacks that may be absorbed in prior taxable years, see §1.1502-21(b).

(vii) *Example.* P, a holding company that is not an insurance company, owns all of the stock of S, a nonlife insurance company, and L1, a life insurance company. L1 owns all of the stock of L2, a life insurance company. Both L1 and L2 satisfy the eligibility requirements of §1.1502-47(b)(11). Each corporation uses the calendar year as its taxable year and none of P, S, L1 or L2 are engaged in a farming business (within the meaning of section 263A(e)(4)). For 2021, the group first files a consolidated return for which the election under section 1504(c)(2) is effective. P and S filed consolidated returns for 2019 and 2020. In 2021, the P-S group sustains a nonlife consolidated net operating loss that is attributable entirely to S (see §1.1502-21(b)). The election in 2020 under section 1502(c)(2) does not result under paragraph (d)(1) of this section in the creation of a new group or the termination of the P-S group. The loss is carried back to the consolidated return years 2019 and 2020 of P and S. Pursuant to §1.1502-21(b), the loss may be used to offset S's income in 2019 and 2020 without limitation, and the loss may be used to offset P's income in those years, subject to the limitation in section 172(a) (see §1.1502-21(b)). The portion of the loss not absorbed in 2019 and 2020 may serve as a nonlife subgroup loss in 2021 that may set off the consolidated LICTI of L1 and L2 under paragraphs (e)(2) and (h) of this section.

(3) \* \* \*

(ii) *Additional principles.* In applying §1.1502-22 to nonlife consolidated net capital loss carryovers and carrybacks, the principles set forth in paragraph (f)(2)(iii) through (v) of this section for applying §1.1502-21 to nonlife consolidated net operating loss carryovers and carrybacks also apply, without regard to the limitation in paragraph (f)(2)(vi) of this section.

\* \* \* \* \*

(g) *Consolidated LICTI—(1) General rule.* Consolidated LICTI is the consoli-

dated taxable income of the life subgroup, computed under §1.1502-11 as modified by this paragraph (g).

(2) *Life consolidated net operating loss deduction*—(i) *In general*. In applying §1.1502-21, the rules in this paragraph (g)(2) apply in determining for the life subgroup the life net operating loss and the portion of the life net operating loss carryovers and carrybacks to the taxable year.

(ii) *Life CNOL*. The life consolidated net operating loss is determined under §1.1502-21(e) by treating the life subgroup as the group.

(iii) *Carrybacks*—(A) *General rule*. The portion of the life consolidated net operating loss for the life subgroup, if any, that is eligible to be carried back under §1.1502-21 is carried back to the appropriate years (whether consolidated or separate) before the life consolidated net operating loss may be used as a life subgroup loss under paragraphs (e) (1) and (j) of this section to set off non-life consolidated taxable income in the year the loss arose. The election under section 172(b)(3) to relinquish the entire carryback period for the consolidated net operating loss of the life subgroup may be made by the common parent of the group.

(B) *Special rule for life consolidated net operating losses arising in 2018, 2019, or 2020*. If a life consolidated net operating loss arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, is carried back to a life insurance company taxable year beginning before January 1, 2018, then

such life consolidated net operating loss is treated as an operations loss carryback (within the meaning of section 810, as in effect prior to its repeal) of such company to such taxable year.

(iv) *Subgroup rule*. In determining the portion of the life consolidated net operating loss that is absorbed when the loss is carried back to a consolidated return year, §1.1502-21 is applied by treating the life subgroup as the group. Therefore, the absorption is determined without taking into account any nonlife subgroup losses that were previously reported on a consolidated return as setting off life consolidated taxable income for the year to which the life subgroup loss is carried back.

(v) *Carryovers*. The portion of the life consolidated net operating loss that is not absorbed in a prior year as a carryback, or as a life subgroup loss that set off nonlife consolidated taxable income for the year the loss arose, constitutes a life carryover under this paragraph (g)(2) to reduce consolidated LICTI before that portion may constitute a life subgroup loss that sets off nonlife consolidated taxable income for that particular year. For limitations on the use of nonlife carryovers to offset nonlife consolidated taxable income or consolidated LICTI, see §1.1502-21(b).

(3) *Life consolidated capital gain net income or loss*—(i) [Reserved]

\* \* \* \*

(h) \* \* \*

(2) \* \* \*

(ii) \* \* \* Additionally, the amount of consolidated LICTI that may be offset by nonlife consolidated net operating loss

carryovers may be subject to limitation (see section 172 and §1.1502-21(a)).

\* \* \* \*

(3) \* \* \*

(iv) \* \* \* The amount of consolidated LICTI that may be offset by nonlife consolidated net operating loss carryovers may be subject to limitation (see section 172 and §1.1502-21(a)).

\* \* \* \*

(4) *Examples*. The following examples illustrate the principles of this paragraph (h). In the examples, L indicates a life company, S is a nonlife insurance company, another letter indicates a nonlife company that is not an insurance company, no company has farming losses (within the meaning of section 172(b)(1)(B)), and each corporation uses the calendar year as its taxable year.

\* \* \* \*

(ii) *Example 2. (A)* The facts are the same as in paragraph (h)(4)(i) of this section, except that, for 2021, S's separate net operating loss is \$200. Assume further that L's consolidated LICTI is \$200. Under paragraph (h)(3)(vi) of this section, the offsettable nonlife consolidated net operating loss is \$100 (the nonlife consolidated net operating loss computed under paragraph (f)(2)(ii) of this section (\$200), reduced by the separate net operating loss of I (\$100)). The offsettable nonlife consolidated net operating loss that may be set off against consolidated LICTI in 2021 is \$35 (35 percent of the lesser of the offsettable \$100 or consolidated LICTI of \$200). See section 1503(c)(1) and paragraph (h)(3)(x) of this section. S carries over a loss of \$65, and I carries over a loss of \$100, to 2022 under paragraph (f)(2) of this section to be used against nonlife consolidated taxable income (consolidated net operating loss (\$200) less amount used in 2020 (\$35)). Under paragraph (h)(2)(ii) of this section, the offsettable nonlife consolidated net operating loss that may be carried to 2022 is \$65 (\$100 minus \$35). The facts and results are summarized in the following table.

**Table 1 to paragraph (h)(4)(ii)(A)**

(Dollars omitted)

		Facts	Offsettable	Limit	Unused Loss
		(a)	(b)	(c)	(d)
1	P	100			
2	S	(200)	(100)		(65)
3	I	(100)			(100)
4	Nonlife Subgroup	(200)	(100)	(100)	(165)
5	L	200	200		
6	35% of lower of line 4(c) or 5(c)			35	
7	Unused offsettable loss				(65)

(B) Accordingly, under paragraph (e) of this section, consolidated taxable income is \$165 (line 5(a) minus line 6(c)).

(iii) *Example 3.* The facts are the same as in paragraph (h)(4)(ii) of this section, with the following additions for 2022. The nonlife subgroup has nonlife consolidated taxable income of \$50 (all of which is attributable to I) before the nonlife consolidated net operating loss deduction under paragraph (f)(2) of this section. Consolidated LICTI is \$100. Under paragraph (f)(2) of this section, \$50 of the nonlife consolidated net operating loss carryover (\$165) is used in 2022 and, under paragraph (h)(3)(vi) and (vii) of this section, the portion used in 2021 is attributable to I, the ineligible nonlife member. Accordingly, the offsettable nonlife consolidated net operating loss from 2021 under paragraph (h)(3)(ii) of this section is \$65, the unused loss from 2020. The offsettable nonlife consolidated net operating loss in 2022 is \$22.75 (35 percent of the lesser of the offsettable loss of \$65 or consolidated LICTI of \$100). Accordingly, under paragraph (e) of this section, consolidated taxable income is \$77.25 (consolidated LICTI of \$100 minus the offsettable loss of \$22.75).

\* \* \* \* \*

(j) \* \* \*

(3) *Examples.* The following examples illustrate the principles of this paragraph (j). In the examples, L indicates a life company, S is a nonlife insurance company, another letter indicates a nonlife company that is not an insurance company, no company has farming losses (within the meaning of section 172(b)(1)(B)), and each corporation uses the calendar year as its taxable year.

(i) *Example 1.* P, S, L1 and L2 constitute a group that elects under section 1504(c)(2) to file a consolidated return for 2021. In 2021, the nonlife subgroup consolidated taxable income is \$100 and there is \$20 of nonlife consolidated net capital loss that cannot be carried back under paragraph (f) of this section to taxable years (whether consolidated or separate) preceding 2021. The nonlife subgroup has no carryover from years prior to 2021. The life consolidated net operating loss is \$150, which under paragraph (g) of this section includes life consolidated capital gain net income of \$25. Since life consolidated capital

gain net income is zero for 2021, the nonlife capital loss offset is zero. However, \$100 of life consolidated net operating loss sets off the \$100 nonlife consolidated taxable income in 2021. The life subgroup carries under paragraph (g)(2) of this section to 2022 \$50 of the life consolidated net operating loss (\$150 minus \$100). The \$50 carryover will be used in 2022 (subject to the limitation in section 172(a)) against life subgroup income before it may be used in 2022 to setoff nonlife consolidated taxable income.

(ii) *Example 2.* The facts are the same as in paragraph (j)(3)(i) of this section, except that, for 2021, the nonlife consolidated taxable income is \$150 (this amount is entirely attributable to S and includes nonlife consolidated capital gain net income of \$50), consolidated LICTI is \$200, and a life consolidated net capital loss is \$50. Assume that the \$50 life consolidated net capital loss sets off the \$50 nonlife consolidated capital gain net income. Consolidated taxable income under paragraph (e) of this section is \$300 (nonlife consolidated taxable income (\$150) minus the setoff of the life consolidated net capital loss (\$50), plus consolidated LICTI (\$200)).

(iii) *Example 3.* The facts are the same as in paragraph (j)(3)(ii) of this section, except that, for 2022, the nonlife consolidated net operating loss is \$150. This entire amount is attributable to S; thus, it is eligible to be carried back to 2021 against nonlife consolidated taxable income under paragraph (f)(2) of this section and §1.1502-21(b). If P, the common parent, does not elect to relinquish the carryback under section 172(b)(3), the entire \$150 will be carried back, reducing 2021 nonlife consolidated taxable income to zero and nonlife consolidated capital gain net income to zero. Under paragraph (h)(3)(xii) of this section, the setoff in 2021 of the nonlife consolidated capital gain net income (\$50) by the life consolidated net capital loss (\$50) is restored. Accordingly, the 2021 life consolidated net capital loss may be carried over by the life subgroup to 2022. Under paragraph (e) of this section, after the carryback, consolidated taxable income for 2021 is \$200 (nonlife consolidated taxable income (\$0) plus consolidated LICTI (\$200)).

(iv) *Example 4.* The facts are the same as in paragraph (j)(3)(iii) of this section, except that P elects under section 172(b)(3) to relinquish the carryback of \$150 arising in 2022. The setoff in Example 2 is not restored. However, the offsettable nonlife consolidated net operating loss for 2022 (or that may be carried over from 2022) is zero. See paragraph (h)(3)(viii) of this section. Nevertheless, the \$150 nonlife

consolidated net operating loss may be carried over to be used by the nonlife group.

(v) *Example 5.* P owns all of the stock of S1 and of L1. On January 1, 2017, L1 purchases all of the stock of L2. For 2021, the group elects under section 1504(c)(2) to file a consolidated return. For 2021, L1 is an eligible corporation under paragraph (c)(11) of this section but L2 is ineligible. Thus, L1 but not L2 is a member for 2021. For 2021, L2 sustains a net operating loss, which cannot be carried back (see section 172(b)). For 2021, L2 is treated under paragraph (d)(6) of this section as a member of a controlled group of corporations under section 1563 with P, S, and L1. For 2022, L2 is eligible and is included on the group's consolidated return. L2's net operating loss for 2021 that may be carried to 2022 is not treated under paragraph (b)(10) of this section as having been sustained in a separate return limitation year for purposes of computing consolidated LICTI of the L1-L2 life subgroup for 2022. Furthermore, the portion of L2's net operating loss not used under paragraph (g)(2) of this section against life subgroup income in 2022 may be included in offsettable life consolidated net operating loss under paragraph (j)(2) and (h)(3)(i) of this section that reduces in 2022 nonlife consolidated taxable income (subject to the limitation in section 172(a)) because L2's loss in 2021 was not sustained in a separate return limitation year under paragraph (j)(2) and (h)(3)(ix)(A) of this section or in a separate return year (2021) when an election was not in effect under section 1504(c)(2) or section 243(b)(2).

\* \* \* \* \*

(n) \* \* \*

(4) The rules of paragraphs (a)(2)(i), (a)(2)(ii), (b)(1) through (b)(4), (b)(9), (b)(10), (b)(12), (b)(13)(ii), (d)(5)(i), (d)(5)(ii), (d)(7)(ii), (f)(2)(iii), (f)(2)(vi), (f)(2)(vii), (f)(3)(ii), (g), (h)(4)(ii), (h)(4)(iii), and (j)(3) of this section apply to taxable years beginning after [EFFECTIVE DATE OF FINAL RULE].

Douglas W. O'Donnell  
Acting Deputy Commissioner for  
Services and Enforcement.

(Filed by the Office of the Federal Register on July 2, 2020, 4:15 p.m., and published in the issue of the Federal Register for July 8, 2020, 85 F.R. 40927)

# Definition of Terms

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

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

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

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

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

new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

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

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

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

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

# Abbreviations

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

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

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

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

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<sup>1</sup>A 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<sup>1</sup>**

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<sup>1</sup> A 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.

# **Internal Revenue Service**

## **Washington, DC 20224**

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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/](http://www.irs.gov/irb/).

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