

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2020-44
October 26, 2020

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.

EMPLOYMENT TAX

T.D. 9924, page 943.

These final regulations provide guidance for employers concerning income tax withholding from employees' wages. These final regulations concern the amount of Federal income tax employers withhold from employees' wages, implement changes in the Internal Revenue Code made by the Tax Cuts and Jobs Act, and reflect the redesigned withholding allowance certificate (Form W-4) and related IRS publications. These final regulations affect employers that pay wages subject to Federal income tax withholding and employees who receive wages subject to Federal income tax withholding.

INCOME TAX

T.D. 9910, page 915.

These final regulations provide additional guidance regarding the base erosion and anti-abuse tax imposed on certain large corporate taxpayers with respect to certain payments made to foreign related parties. The final regulations affect corporations with substantial gross receipts that make payments to foreign related parties.

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 1.59A-1-1.59A-10

T.D. 9910

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Base Erosion and Anti- Abuse Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the base erosion and anti-abuse tax imposed on certain large corporate taxpayers with respect to certain payments made to foreign related parties. The final regulations affect corporations with substantial gross receipts that make payments to foreign related parties.

DATES: *Effective Date:* The final regulations are effective December 8, 2020.

Applicability Dates: For dates of applicability, see §§ 1.59A-10 and 1.6031(a)-1(f)(2).

FOR FURTHER INFORMATION CONTACT: Sheila Ramaswamy or Karen Walny at (202) 317-6938 or Azeka J. Abramoff at (202) 317-3800 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The base erosion and anti-abuse tax (“BEAT”) in section 59A was added to the Internal Revenue Code (the “Code”) by the Tax Cuts and Jobs Act, Public Law 115-97 (2017), which was enacted on December 22, 2017. Section 59A imposes on each applicable taxpayer a tax equal to the base erosion minimum tax amount for the taxable year. On December 6, 2019, the

Department of the Treasury (“Treasury Department”) and the IRS published final regulations (TD 9885) under sections 59A, 383, 1502, 6038A, and 6655 (the “2019 final regulations”) in the **Federal Register** (84 FR 66968). On December 6, 2019, the Treasury Department and the IRS also published proposed regulations (REG-112607-19) under section 59A and proposed amendments to 26 CFR part 1 under section 6031 of the Code (the “proposed regulations”) in the **Federal Register** (84 FR 67046). On February 19, 2020, the Treasury Department and the IRS published a correction to the 2019 final regulations in the **Federal Register** (85 FR 9369).

No public hearing was requested or held. The Treasury Department and the IRS received written comments with respect to the proposed regulations. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request.

Summary of Comments and Explanation of Revisions

I. Overview

The final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. This Summary of Comments and Explanation of Revisions discusses those revisions as well as comments received in response to the solicitation of comments in the proposed regulations. Comments outside the scope of this rulemaking generally are not addressed but may be considered in connection with future guidance projects.

The final regulations provide guidance under sections 59A, 1502, and 6031 regarding certain aspects of the BEAT. Part II of this Summary of Comments and Explanation of Revisions describes rules relating to the determination of a taxpayer’s aggregate group for purposes of determining gross receipts and the base erosion percentage. Part III of this Summary of Comments and Explanation of Revisions describes rules relating to an election to waive deductions for purposes of the BEAT. Part IV of this Summary of Comments and Explanation of Revisions

describes rules relating to the application of the BEAT to partnerships. Part V of this Summary of Comments and Explanation of Revisions describes rules relating to the anti-abuse rule provided in § 1.59A-9(b)(4) with respect to certain basis step-up transactions. Part VI of this Summary of Comments and Explanation of Revisions describes possible future guidance relating to the qualified derivative payment (“QDP”) reporting requirements in § 1.59A-6 and § 1.6038A-2(b)(7)(ix).

II. Determination of a Taxpayer’s Aggregate Group

The BEAT applies only to a taxpayer that is an applicable taxpayer. Section 59A(a). Generally, a taxpayer determines whether it is an applicable taxpayer based upon its gross receipts and base erosion percentage. § 1.59A-2(b). When a taxpayer is a member of an aggregate group, the gross receipts test and base erosion percentage test are applied on the basis of its aggregate group. § 1.59A-2(c)(1). Generally, a taxpayer and its affiliated corporations are aggregated for purposes of determining gross receipts and the base erosion percentage if they are members of the same controlled group of corporations, as defined in section 1563(a) with certain modifications (including by substituting “more than 50 percent” for “at least 80 percent”). See § 1.59A-1(b)(1).

The proposed regulations provided additional guidance regarding how a taxpayer determines its aggregate group, including rules relating to short taxable years, members joining and leaving a taxpayer’s aggregate group, and predecessors. The preamble to the proposed regulations requested comments on how the aggregate group rules should apply in various situations. REG-112607-19, 84 FR 67046, 67047-48 (December 6, 2019). Part II.A of this Summary of Comments and Explanation of Revisions addresses the calculation of gross receipts and the base erosion percentage when either the taxpayer or a member of the taxpayer’s aggregate group has a short taxable year. Part II.B of this Summary of Comments and Explanation of Revisions addresses considerations relating to when a member joins or leaves

an aggregate group. Part II.C of this Summary of Comments and Explanation of Revisions addresses the application of the aggregate group rules to predecessors and successors.

A. Rules Relating to the Determination of Gross Receipts and the Base Erosion Percentage for a Short Taxable Year

Section 1.59A-2(c)(3) provides that a taxpayer that is a member of an aggregate group measures the gross receipts and base erosion percentage of its aggregate group for a taxable year by reference to the taxpayer's gross receipts, base erosion tax benefits, and deductions for the taxable year, and the gross receipts, base erosion tax benefits, and deductions of each member of the aggregate group for the taxable year of the member that ends with or within the taxpayer's taxable year (the "with-or-within method"). Proposed § 1.59A-2(c)(5) required a taxpayer with a taxable year of fewer than 12 months (a short taxable year) to annualize its own gross receipts by multiplying the gross receipts for the short taxable year by 365 and dividing the result by the number of days in the short taxable year.

Proposed § 1.59A-2(c)(5) also provided that a taxpayer with a short taxable year must use a reasonable approach to determine the gross receipts and base erosion percentage of its aggregate group members for the short taxable year. The proposed regulations indicated that, in determining whether the taxpayer's aggregate group satisfies the gross receipts test and base erosion percentage test for the taxpayer's short taxable year, a reasonable approach would neither over-count nor under-count the gross receipts, base erosion tax benefits, and deductions of the members of the taxpayer's aggregate group, even if the taxable year of a member or members of the aggregate group does not end with or within the short period. Proposed § 1.59A-2(c)(5). The preamble to the proposed regulations requested comments on whether more specific guidance was needed, and if so, how the gross receipts and base erosion percentage of an aggregate group should be determined when the applicable taxpayer has a short taxable year. REG-112607-19, 84 FR 67046, 67047 (December 6, 2019).

A comment supported the rule in the proposed regulations allowing a taxpayer to use a reasonable approach to determine the gross receipts and base erosion percentage of its aggregate group for a short taxable year and viewed more detailed guidance regarding short taxable years to be unnecessary. The comment stated that the operation of the with-or-within method, in conjunction with a reasonable approach to taking into account gross receipts, base erosion tax benefits, and deductions of aggregate group members, would prevent either the over-counting or under-counting of items in situations involving short taxable years. However, this comment also suggested that a reasonable approach would exclude the gross receipts, base erosion tax benefits, and deductions of an aggregate group member if the member's taxable year did not end with or within a short taxable year of the taxpayer. The Treasury Department and the IRS agree that a reasonable approach should prevent over-counting and under-counting. Therefore, the final regulations retain the rule in the proposed regulations that permits the use of a reasonable approach to determine whether a taxpayer's aggregate group meets the gross receipts test and base erosion percentage test with respect to a short taxable year of the taxpayer.

However, the Treasury Department and the IRS are concerned that when a member does not have a taxable year that ends with or within a short taxable year of a taxpayer, some taxpayers may take the view (as suggested in the comment described in the preceding paragraph) that excluding the gross receipts, base erosion tax benefits, and deductions of the member from the taxpayer's aggregate group is a reasonable approach. The Treasury Department and the IRS do not view such exclusions as a reasonable approach. Accordingly, the final regulations clarify that such a method constitutes an unreasonable approach. § 1.59A-2(c)(5)(i)(B). In addition, to provide guidance for taxpayers in determining whether a particular approach is reasonable and does not over-count nor under-count, the final regulations include examples of methods that may or may not constitute a reasonable approach. *See id.*

B. Members Leaving and Joining an Aggregate Group

1. Close of Taxable Year Rule for Determining Gross Receipts and Base Erosion Percentage

a. When the deemed closing of a taxable year occurs

The proposed regulations provided guidance clarifying how the gross receipts and the base erosion percentage of an aggregate group are determined when members join or leave a taxpayer's aggregate group, such as through a sale of the stock of a member to a third party. Proposed § 1.59A-2(c)(4) provided that, in determining the gross receipts and the base erosion percentage of a taxpayer's aggregate group, only items of members that occur during the period that they were members of the taxpayer's aggregate group are taken into account. Under this rule, items of a member that occur before the member joins the aggregate group of the taxpayer or after the member leaves the aggregate group of the taxpayer are not taken into account in determining the gross receipts or base erosion percentage of the taxpayer's aggregate group.

To implement this cut-off rule and determine which items occurred while a corporation was a member of a particular aggregate group, proposed § 1.59A-2(c)(4) treated a corporation that joins or leaves an aggregate group (in a transaction that does not otherwise result in a taxable year-end) as having a deemed taxable year-end. Specifically, proposed § 1.59A-2(c)(4) provided that this deemed taxable year-end occurs immediately before the corporation joins or leaves the aggregate group ("time-of-transaction rule"). The proposed regulations permitted a taxpayer to determine items attributable to this deemed short taxable year by either deeming a close of the corporation's books or, in the case of items other than extraordinary items (as defined in § 1.1502-76(b)(2)(ii)(C)), making a pro-rata allocation without a closing of the books.

Comments requested that the deemed taxable year-end occur at the end of the day, rather than immediately before the time of the transaction, to better align with other provisions of the Code and regula-

tions. Comments noted that an end-of-day rule would be more consistent with provisions of the Code and regulations such as section 381 and § 1.1502-76(b). See section 381 (providing that an acquiring corporation succeeds to and takes into account certain attributes as of the close of the day, rather than the time of the acquisition transaction); § 1.1502-76(b) (providing that, when a member joins or leaves a consolidated group, it has a taxable year-end at the end of the day).

The final regulations adopt this recommendation. Specifically, when a corporation has a deemed taxable year-end under § 1.59A-2(c)(4), the deemed taxable year-end is treated as occurring at the end of the day of the transaction. § 1.59A-2(c)(4)(ii). Thus, a new taxable year is deemed to begin at the beginning of the day after the transaction. A taxpayer determines items attributable to the deemed short taxable years ending upon and beginning the day after the deemed taxable year-end by either deeming a close of the corporation's books or, in the case of items other than extraordinary items, making a pro-rata allocation without a closing of the books. § 1.59A-2(c)(4)(iii). Extraordinary items that occur on the day of, but after, the transaction that causes the corporation to join or leave the aggregate group are treated as occurring in the deemed taxable year beginning the next day. For this purpose, the term "extraordinary items" has the meaning provided in § 1.1502-76(b)(2)(ii)(C). This term is also expanded to include any other payment that is not made in the ordinary course of business and that would be treated as a base erosion payment.

b. Alternative to deemed year-end approach

One comment supported the approach in the proposed regulations to the deemed year-end rule, which it noted allows taxpayers flexibility to choose between the pro-rata allocation or closing of the books methods. However, the comment also expressed support for a simplified "no-cut-off" alternative to the deemed year-end framework in the proposed regulations, which could reduce the need for sharing information between a selling aggregate group and a purchaser.

Under the comment's simplified "no-cut-off" alternative, there would be no deemed year-end upon a corporation's entry to or exit from an aggregate group; rather, the corporation's full year would be taken into account by the acquirer's aggregate group. The comment acknowledged that this simplified approach would result in the "departed" aggregate group including no items for the year and the "acquiring" aggregate group taking into account all of the corporation's items for the year, which may be distortionary. The comment also suggested that it may be appropriate to backstop this simplified "no-cut-off" rule with an anti-abuse rule that requires a deemed year-end if the transaction is arranged with a principal purpose of enabling a taxpayer to fall below the gross receipts or base erosion percentage thresholds.

The final regulations do not adopt the simplified "no-cut-off" alternative. Although that alternative may simplify some elements of compliance with the aggregate group rules, the Treasury Department and the IRS have determined that a rule that determines the gross receipts and base erosion tax benefits of an aggregate group should include only the gross receipts, base erosion tax benefits, and deductions of entities attributable to the period in which they were members of the aggregate group. The "no-cut-off" alternative proposed is inherently less precise and has the potential for abuse. For example, in the case of an acquisition near the end of a taxable year, the "no-cut-off" alternative could shift nearly a full year's items from the seller's aggregate group to the acquirer's aggregate group.

In addition, the Treasury Department and the IRS have determined that the additional subjectivity that would result from coupling the rule with an anti-abuse backstop to address the potential for abuse identified in the comment would lead to less certainty with respect to a key threshold in determining whether a taxpayer is subject to the BEAT.

2. Aggregate Group Members with Different Taxable Years Leading to Over-and-Under-Counting of Gross Receipts

A comment expressed concern that the deemed close of the taxable year that oc-

curs when a member joins or leaves an aggregate group would create the potential for over-counting of gross receipts, base erosion tax benefits, and deductions of a member when applied in conjunction with the with-or-within method. This situation can arise when the taxpayer and a member of the aggregate group have different taxable years.

The comment illustrated this concern with the following example. A taxpayer has a calendar taxable year and its aggregate group includes DC, a domestic corporation with a June 30 year-end. On November 30, 2020, DC leaves the taxpayer's aggregate group. The comment explained that, under the with-or-within rule of § 1.59A-2(c)(3), the taxpayer is required to not only take into account DC's gross receipts for the full taxable year ended June 30, 2020, (a full 12-month taxable year) but also a second short taxable year of July 1, 2020, through November 30, 2020 (a 5-month short taxable year). This result occurs because, from the perspective of the taxpayer, both DC's full 12-month taxable year and DC's 5-month short taxable year end "with or within" the taxpayer's calendar taxable year ending on December 31, 2020. As a result, the taxpayer would include 17 months of gross receipts from DC in taxpayer's taxable year ending December 31, 2020.

The comment recommended that an annualization rule or another alternative apply to the gross receipts test so that a taxpayer is not required to take into account more than 12 months of gross receipts of an aggregate group member when a member joins or leaves an aggregate group.

The comment also suggested that an annualization rule may be appropriate for the base erosion percentage test because an annualization rule would avoid over-weighting base erosion tax benefits and deductions. Depending on the taxpayer's particular facts, the comment noted that this suggested rule could cause a taxpayer's aggregate group to satisfy the base erosion percentage test or to fall below the relevant threshold established for that test.

The final regulations adopt this comment. Section 1.59A-2(c)(5)(ii)(A) provides that, if a member of a taxpayer's aggregate group has more than one taxable year that ends with or within the taxpayer's taxable year and together those

taxable years are comprised of more than 12 months, then the member's gross receipts, base erosion tax benefits, and deductions for those years are annualized to 12 months for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group. To annualize, the amount is multiplied by 365 and the result is divided by the total number of days in the year or years.

The final regulations also adopt a corresponding rule to address short taxable years of members. Specifically, if a member of the taxpayer's aggregate group changes its taxable year-end, and as a result the member's taxable year (or years) ending with or within the taxpayer's taxable year is comprised of fewer than 12 months, then for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group, the member's gross receipts, base erosion tax benefits, and deductions for that year (or years) are annualized to 12 months. § 1.59A-2(c)(5)(ii)(B). This rule does not apply if the change in the taxable year-end is a result of the application of § 1.1502-76(a), which provides that new members of a consolidated group adopt the common parent's taxable year. *But see* § 1.59A-2(c)(5)(iii) (providing an anti-abuse rule that applies to transactions with a principal purpose of changing the period taken into account for the gross receipts test or the base erosion percentage test).

For example, assume that an aggregate group member and the taxpayer both have calendar-year taxable years; then, in January of 2021, the aggregate group member changes its taxable year-end to January 31. Under these facts, the taxpayer's 2021 calendar year would only include the gross receipts, base erosion tax benefits, and deductions of the one-month short year of the aggregate group member because that is the only taxable year of the member that ends with or within the taxpayer's calendar year taxable year. Gross receipts would be undercounted, and the member's contribution to the aggregate group's base erosion percentage would be given insufficient weight in the taxpayer's 2021 calendar year. This difference would not resolve itself in subsequent years because, in the taxpayer's 2022 taxable year and each taxable year thereafter, the taxpayer will take into account only a 12-month pe-

riod with respect to the aggregate group member – the taxable year from February 1 through January 31. Thus, absent this rule, the equivalent of 11 months of the member's contributions to the gross receipts and base erosion percentage would not be taken into account by the aggregate group because the taxpayer's 2021 calendar year computation would only include one month of aggregate group member activity. Accordingly, the final regulations provide that the member's gross receipts, base erosion tax benefits, and deductions for its one-month short-year ending January 31, 2021, are extrapolated and annualized to a full 12-month period solely for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group when resulting from a change in taxable year. § 1.59A-2(c)(5)(ii)(B).

The final regulations also adopt a corresponding anti-abuse rule to address other types of transactions that may achieve a similar result of excluding gross receipts or base erosion percentage items of a taxpayer or a member of the taxpayer's aggregate group that are undertaken with a principal purpose of avoiding applicable taxpayer status. *See* § 1.59A-2(c)(5)(iii). Assuming a requisite principal purpose, an example that could implicate this rule includes a transaction in which a taxpayer that is close to satisfying the gross receipts test transfers a portion of its revenue-generating assets to a newly formed domestic corporation that is a member of the taxpayer's aggregate group (but not a member of the taxpayer's consolidated group) and that has a different taxable year that does not end with or within the taxpayer's current taxable year. Another example, also assuming a requisite principal purpose, includes a transaction in which the stock of a member of the taxpayer's aggregate group is transferred to a consolidated group that is also a member of the taxpayer's aggregate group and that has a different taxable year that does not end with or within the taxpayer's current taxable year.

3. Deferred Deductions

A comment requested that § 1.59A-2(c)(4) be revised to clarify the treatment of items that are paid or accrued in a period

before a corporation joins a taxpayer's aggregate group. As an example, the comment described a corporation's payment of interest to a foreign related party that gives rise to a base erosion payment in the taxable year of the payment, but that is not a base erosion tax benefit because the item is not currently deductible due to the limitations on deducting business interest expense in section 163(j). The comment suggested that, if the corporation subsequently becomes a member of an aggregate group of a different taxpayer (for example, because the corporation is sold to an unrelated buyer, and thereafter becomes a member of the buyer's aggregate group), the buyer's aggregate group should not have to take into account the base erosion tax benefit in the buyer's base erosion percentage when the business interest expense becomes deductible under section 163(j).

The final regulations do not adopt this comment. Under the statutory framework of the BEAT, whether a deduction is a base erosion tax benefit is determined solely with respect to whether the amount was a base erosion payment when it was paid or accrued. Section 59A(c)(2) and § 1.59A-3(c)(1) do not retest the base erosion payment to determine whether the payee continues to be a foreign related party of the taxpayer when the taxpayer claims the deduction.

C. Predecessors and Successors

Proposed § 1.59A-2(c)(6)(i) provided that, in determining gross receipts, any reference to a taxpayer includes a reference to any predecessor of the taxpayer, including the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation. To prevent over-counting, the proposed regulations provided that, if the taxpayer or any member of its aggregate group is also a predecessor of the taxpayer or any member of its aggregate group, the gross receipts, base erosion tax benefits, and deductions of each member are taken into account only once. Proposed § 1.59A-2(c)(6)(ii).

A comment recommended taking into account gross receipts of foreign predecessor corporations only to the extent

the gross receipts are taken into account in determining income that is effectively connected with the conduct of a U.S. trade or business (“ECI”) of the foreign predecessor corporation, which would be consistent with the ECI rule for gross receipts of foreign corporations in § 1.59A-2(d). The final regulations adopt this comment. Section 1.59A-2(c)(6)(i) clarifies that the operating rules set forth in § 1.59A-2(c) (aggregation rules) and § 1.59A-2(d) (gross receipts test) apply to the same extent in the context of the predecessor rule. Thus, the ECI limitation on gross receipts in § 1.59A-2(d)(3) continues to apply to the successor.

III. Election to Waive Allowable Deductions

For purposes of determining a taxpayer’s base erosion tax benefits and the base erosion percentage, the proposed regulations provided that all deductions that could be properly claimed by a taxpayer are treated as allowed deductions. Proposed § 1.59A-3(c)(5). However, if a taxpayer elected to forego a deduction and followed specified procedures (the “BEAT waiver election”), the proposed regulations provided that the foregone deduction would not be treated as a base erosion tax benefit. Proposed § 1.59A-3(c)(6). Generally, under the proposed regulations, any deduction waived pursuant to the BEAT waiver election is waived for all U.S. federal income tax purposes. Proposed § 1.59A-3(c)(6)(ii)(A). The proposed regulations permitted a taxpayer to make the BEAT waiver election on its original filed Federal income tax return, on an amended return, or during the course of an examination of the taxpayer’s income tax return for the relevant taxable year pursuant to procedures prescribed by the Commissioner. Proposed § 1.59A-3(c)(6)(iii).

Part III.A of this Summary of Comments and Explanation of Revisions addresses when a taxpayer is eligible to make the BEAT waiver election. Part III.B of this Summary of Comments and Explanation of Revisions addresses whether deductions waived pursuant to the BEAT waiver election should be included in the denominator of the base erosion percentage. Part III.C of this Summary of

Comments and Explanation of Revisions addresses comments on the decrease of deductions waived. Part III.D of this Summary of Comments and Explanation of Revisions addresses comments on the inclusion of reinsurance premiums paid in the BEAT waiver election. Part III.E of this Summary of Comments and Explanation of Revisions addresses comments relating to revoking certain elections and making late elections to allow taxpayers to take into account the BEAT waiver election. Part III.F of this Summary of Comments and Explanation of Revisions addresses comments relating to procedural aspects of the BEAT waiver election. Part III.G of this Summary of Comments and Explanation of Revisions addresses comments relating to the application of the BEAT waiver election to partnerships. Part III.H of this Summary of Comments and Explanation of Revisions addresses the application of the BEAT waiver election to consolidated groups. Part III.I of this Summary of Comments and Explanation of Revisions addresses the interaction of the BEAT waiver election with other regulations.

A. Eligibility for the BEAT Waiver Election

Proposed § 1.59A-3(c)(5) provided that the BEAT waiver election is the sole method by which a deduction that could be properly claimed by taxpayer for the taxable year is not taken into account for BEAT purposes (the “primacy rule”). Proposed § 1.59A-3(c)(6)(i) provided that, “[s]olely for purposes of paragraph (c)(1) of this section” (the definition of a base erosion tax benefit), the amount of allowed deductions is reduced by the amount of deductions that are properly waived. A comment suggested that the phrase “solely for purposes of” in proposed § 1.59A-3(c)(6)(i) is unclear. The comment interpreted the proposed regulations as providing that a taxpayer can make the BEAT waiver election only if the waiver of a deduction, when taken together with any waivers by other members of the taxpayer’s aggregate group, would lower the taxpayer’s base erosion percentage below the base erosion percentage threshold applicable to the taxpayer. The comment also recommended that the Treasury Department and the IRS

clarify that the primacy rule and the BEAT waiver election do not affect a taxpayer’s ability to not claim allowable deductions for tax purposes other than section 59A.

The final regulations explicitly clarify that, in order to make or increase the BEAT waiver election under § 1.59A-3(c)(6), the taxpayer must determine that the taxpayer could be an applicable taxpayer for BEAT purposes but for the BEAT waiver election. § 1.59A-3(c)(6)(i). Thus, for example, a controlled foreign corporation that does not have income that is effectively connected with the conduct of a trade or business in the United States cannot make a BEAT waiver election because the controlled foreign corporation cannot be an applicable taxpayer.

In addition, when a taxpayer does not make a BEAT waiver election (or when this waiver is not permitted), § 1.59A-3(c)(5) and § 1.59A-3(c)(6)(i) have no bearing on whether or how a taxpayer’s failure to claim an allowable deduction, or to otherwise “waive” a deduction, is respected or taken into account for tax purposes other than section 59A. *See generally* § 1.59A-3(c)(5). In other words, the BEAT waiver election should not affect any existing law addressing “waiver” outside of the specific situation covered by the BEAT waiver (electing not to claim a deduction in order to avoid applicable taxpayer status).

B. Effect of the BEAT Waiver Election on the Base Erosion Percentage

Proposed § 1.59A-2(e)(3)(ii)(G) provided that any deduction not allowed in determining taxable income for the taxable year is not taken into account when determining the denominator of the base erosion percentage. *See also* proposed § 1.59A-3(c)(6)(ii)(A)(1) (generally providing that a waived deduction is treated as having been waived for all purposes of the Code and regulations). A comment asserted that a waived deduction should nonetheless be included in the denominator of the base erosion percentage.

The final regulations do not adopt this comment. This recommendation is inconsistent with § 1.59A-2(e)(3)(ii)(G), which provides that the denominator of the base erosion percentage does not include any deduction that is not allowed in determin-

ing taxable income for the taxable year.¹ A waived deduction is not allowed in determining taxable income for the year. *See* § 1.59A-3(c)(6)(i). By providing that the denominator to the base erosion percentage includes only items allowed in determining taxable income for the taxable year, the denominator operates symmetrically with the numerator because the numerator — base erosion tax benefits — includes only those deductions and other items “allowed by [Chapter 1 of the Code].” *See* section 59A(c)(2)(A)(i).

C. Reduction of Waived Deductions During Audit or on an Amended Return

The proposed regulations provided that a taxpayer may make or increase a BEAT waiver election on an amended Federal income tax return or during the course of an examination of the taxpayer’s income tax return. *See* proposed § 1.59A-3(c)(6)(iii). However, a taxpayer could not decrease the amount of deductions waived under the BEAT waiver election or revoke that election on any amended Federal income tax return or during an examination. *See* proposed § 1.59A-3(c)(6)(iii).

Comments requested that the final regulations permit taxpayers to decrease the amount of deductions that are waived either by filing an amended Federal income tax return or during an examination. Some comments suggested that no policy concerns existed that should prevent taxpayers from being able to reduce the amount of a previously waived deduction. Comments also noted that, given that the proposed regulations permit taxpayers to increase waived amounts on an amended return or during an audit, permitting taxpayers to reduce any waived amounts would not create any additional administrative burden for the IRS.

The final regulations do not adopt this comment. The BEAT waiver election was proposed, in part, in response to comments to prior proposed regulations recommending that the Treasury Department and the IRS clarify whether a deduction that is not claimed is not taken into account for

BEAT purposes. The proposed regulations also included the waiver election, in part, to address taxpayer concerns that, due to the cliff effect of applicable taxpayer status, a marginal amount of base erosion tax benefits could have a greater effect on overall tax liability. The ability to decrease waived amounts does not further the policy goal of addressing the cliff effect of applicable taxpayer status. The proposed regulations provided taxpayers significant flexibility through the BEAT waiver election, which permits taxpayers to choose deductions to waive based on tax optimization and to elect to increase waived deductions at various points after filing their original return, including during an examination. *See* proposed § 1.59A-3(c)(6)(iii). The Treasury Department and the IRS are concerned that expanding taxpayer electivity to permit the reduction of waived amounts will increase uncertainty to the IRS as it assesses tax return positions. The Treasury Department and the IRS are concerned that this uncertainty about taxpayers’ return positions will negatively affect the ability of the IRS to efficiently conduct and close examinations.

D. Waiver of Life and Non-Life Reinsurance Premiums

The BEAT waiver election in the proposed regulations specifically referenced deductions. Proposed § 1.59A-3(c)(6). Comments noted that the term “base erosion tax benefits” includes certain reductions to gross income related to reinsurance that may be treated as reductions to gross receipts, not deductions. *See* § 1.59A-3(b)(1)(iii) (defining a base erosion payment to include “[a]ny premium or other consideration paid or accrued by the taxpayer to a foreign related party of the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A)”; § 1.59A-3(c)(1)(iii) (defining a base erosion tax benefit with respect to a base erosion payment described in § 1.59A-3(b)(1)(iii) as “any reduction under section 803(a)(1)(B) in the gross amount of premiums

and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity reinsurance, or any deduction under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance.”). Because premiums that are reductions to gross income do not technically fit within the terminology used in the waiver provisions, comments requested that final regulations permit a waiver for those items.

The Treasury Department and the IRS have determined that the policy rationale for providing the BEAT waiver election applies to insurance-related base erosion payments, and therefore the BEAT waiver election should be available with respect to base erosion tax benefits described in § 1.59A-3(b)(1)(iii). The final regulations include a provision for the waiver of amounts treated as reductions to gross premiums and other consideration that would otherwise be base erosion tax benefits within the definition of section 59A(c)(2)(A)(iii) and provide that similar operational and procedural rules apply to this waiver, such as the rule providing that the waiver applies for all purposes of the Code and regulations. *See* § 1.59A-3(c)(5). The BEAT waiver election affects the base erosion tax benefits of the taxpayer, not the amount of premium that the taxpayer pays to a foreign insurer or reinsurer (or the amount received by that foreign insurer or reinsurer); therefore, for example, the waiver of reduction to gross premiums and other consideration (or of premium payments that are deductions for federal income tax purposes) does not reduce the amount of any insurance premium payments that are subject to insurance excise tax under section 4371.

E. Revoking Elections and Retroactive Elections in Connection with Bonus Depreciation and Research and Experimentation Capitalization and Amortization

Comments asserted that certain taxpayers filed elections in connection with their

¹ *See* REG-104259-18, 83 FR 65958 (December 21, 2018) (The preamble to the 2018 proposed regulations provided “[t]he numerator of the base erosion percentage only takes into account base erosion tax benefits, which generally are base erosion payments for which a deduction is allowed under the Code for a taxable year. . . . Similarly, the proposed regulations ensure that the denominator of the base erosion percentage only takes into account deductions allowed under the Code by providing that the denominator of the base erosion percentage does not include deductions that are not allowed in determining taxable income for the taxable year.”).

2018 tax returns to either (i) elect under section 59(e)(4) to capitalize and amortize over a 10-year period certain research and experimentation (“R&E”) expenditures that would otherwise be deductible in the year incurred, or (ii) elect not to claim an additional allowance for depreciation under section 168(k) (“bonus depreciation”) before the issuance of the proposed regulations that provided taxpayers with the option of the BEAT waiver election. The section 59(e)(4) and bonus depreciation elections are revocable only with the consent of the Secretary. The comments implied that, if taxpayers had known about the BEAT waiver election when they filed their returns, the taxpayers would not have made the elections under section 59(e)(4) or section 168(k)(7) because the BEAT waiver election would have been a better tax planning technique. The comments recommended that the Treasury Department and the IRS provide automatic relief for taxpayers that seek to revoke their prior elections under section 59(e)(4) or section 168(k)(7) in light of the BEAT waiver election.

Another comment recommended that the Treasury Department and the IRS also permit taxpayers to make retroactive elections to capitalize and amortize costs under section 59A(e)(4) or to not claim bonus depreciation under section 168(k) to provide relief from “permanent BEAT consequences.” The comment cited an example where the taxpayer is entitled to additional deductions or has less regular taxable income in a taxable year as a result of an audit; consequently, the taxpayer had an “unintended” tax liability under section 59A. The comment proposed that the Treasury Department and the IRS permit a taxpayer to retroactively elect to capitalize costs that were previously reported as deductible in the taxable year.

The final regulations do not adopt the recommendations to provide guidance permitting taxpayers to automatically revoke prior capitalization elections under sections 59(e)(4) and 168(k) or make late elections. In both cases, the recommendations would expressly permit taxpayers to use hindsight to change their elections to reduce or eliminate BEAT liability or regular income tax. The use of hindsight in elections involves tax policy considerations broader than the interaction of

the BEAT and the elections under section 59(e)(4) and section 168(k). Because these recommendations involve tax policy considerations that are not just limited to the application of the BEAT, the decision to permit revoking or making a late election is beyond the scope of the final regulations.

F. Procedures for Making the BEAT Waiver Election

1. Documentation Requirements

Proposed § 1.59A-3(c)(6)(i) required taxpayers to report certain information to make the BEAT waiver election. Under the proposed regulations, a taxpayer was required to provide, among other information, a detailed description of the item or property to which the deduction relates, including sufficient information to identify that item or property on the taxpayer’s books and records. Proposed § 1.59A-3(c)(6)(i)(A).

A comment suggested that the final regulations eliminate the information required by § 1.59A-3(c)(6)(i)(A) through (C) (the detailed description, the date or period of the payment or accrual; and the citation for the deduction). The comment stated that the final regulations should eliminate § 1.59A-3(c)(6)(i)(A) because a streamlined disclosure that included only the amount deducted (proposed § 1.59A-3(c)(6)(i)(D)), amount waived (proposed § 1.59A-3(c)(6)(i)(E)), tax return line item (proposed § 1.59A-3(c)(6)(i)(F)), and foreign recipient (proposed § 1.59A-3(c)(6)(i)(G)) would provide sufficient information for the IRS to determine the validity of the election without creating an undue burden on taxpayers. While the comment characterized the information reporting requirements as “onerous,” it did not explicitly describe how or why this requirement is onerous.

The final regulations retain the requirements of proposed § 1.59A-3(c)(6)(i)(A) through (C). See § 1.59A-3(c)(6)(ii)(B)(1) through (3). In administering the BEAT waiver election, the IRS has an interest in obtaining information regarding the deductions being waived and the item or property to which the deduction relates, including sufficient information to identify the item on the taxpayer’s books and

records and to have information about the Code section under which the deduction arises. However, the Treasury Department and the IRS acknowledge that requiring a “detailed” description of the item or property to which the deduction relates is not necessary for this purpose, particularly given that § 1.59A-3(c)(6)(ii)(B)(1) requires sufficient information to identify the item or property on the taxpayer’s books. Accordingly, § 1.59A-3(c)(6)(ii)(B)(1) of the final regulations omits the requirement to provide a “detailed” description. Section 1.59A-3(c)(6)(ii)(B)(6) and (7) is also revised to make certain non-substantive, clarifying changes.

2. Partial Waivers

Proposed § 1.59A-3(c)(6)(ii)(B) provided that, if a taxpayer makes the election to waive a deduction, in whole or in part, the election is disregarded for certain purposes. A comment observed that the proposed regulations do not expressly provide that the BEAT waiver election permits a partial waiver of a deduction. The comment also suggested that procedural forms should be clear in this regard. The final regulations have been revised to state more explicitly that a deduction may be waived in part. See § 1.59A-3(c)(6)(i); see also §§ 1.59A-3(c)(6)(ii)(B)(4) and (5), and 1.59A-3(c)(6)(iii)(B). Additionally, the IRS plans to revise Form 8991, *Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts*, to incorporate reporting requirements relating to the reporting of deductions that taxpayers have partially waived.

3. Procedures for BEAT Waiver During the Course of an Examination

Proposed § 1.59A-3(c)(6)(iii) generally provided that a taxpayer may make the BEAT waiver election on its original filed Federal income tax return, on an amended return, or during the course of an examination pursuant to procedures prescribed by the Commissioner. The preamble to the proposed regulations indicated that, unless the Commissioner prescribes specific procedures with respect to waiving deductions during the course of an examination, the same procedures that generally apply to affirmative tax return changes

during an examination would apply. REG-112607-19, 84 FR 67046, 67048 (December 06, 2019). The current procedures for submitting affirmative tax return changes during an examination, which are set forth in the Internal Revenue Manual (IRM), apply together with the provisions in section 6402 and the regulations thereunder (§§301.6402-1 through 301.6402-7).

A comment argued that the final regulations should expand upon the procedures of the IRM and permit a taxpayer to make the BEAT waiver election at any time during the course of an examination, including after all other adjustments have been agreed upon. Additionally, the comment recommended that the IRS consider providing a streamlined procedure for taxpayers to make the BEAT waiver election in connection with examinations that would not require the filing of an amended return because filing an amended return could be burdensome.

The final regulations do not adopt these recommendations because the IRM already provides a procedure that permits taxpayers to submit informal claims, including the BEAT waiver election, during the course of an examination. *See* IRM section 4.46.3.7. The Treasury Department and the IRS view this IRM procedure as serving an important tax administration function—preserving the IRS’s ability to conduct an audit efficiently and ensuring that the IRS has sufficient time to evaluate the merits of the claims. In addition, the Treasury Department and the IRS have determined that it is in the interest of sound tax administration to address procedures regarding claims in the Internal Revenue Manual rather than in the regulations. Further, the Code, regulations, and the IRM are clear that the taxpayer retains a statutory right to submit an amended return that can include a waiver election or increase the waived deductions.

G. Application of the BEAT Waiver Election to Partnerships

Comments recommended generally that the BEAT waiver election be expanded to expressly permit a waiver in connection with deductions that are allocated from a partnership. Some comments recommended that the final regulations clarify that the BEAT waiver election is

made by the partner, rather than by the partnership. These comments suggested certain corresponding changes necessary to coordinate the tax treatment of partners and partnerships. Specifically, a comment recommended that the waived deductions be treated as non-deductible expenditures under section 705(a)(2)(B) – thereby reducing the adjusted basis of a partner’s interest in a partnership – to prevent a corporate partner from subsequently benefitting from waived partnership deductions when disposing of its interest in the partnership.

The final regulations generally adopt these comments and, subject to certain special rules in connection with the centralized partnership audit regime enacted in the Bipartisan Budget Act of 2015 (the “BBA”), explicitly permit a corporate partner in a partnership to make a BEAT waiver election with respect to partnership items. § 1.59A-3(c)(6)(iv)(A). The final regulations also clarify that a partnership may not make a BEAT waiver election. § 1.59A-3(c)(6)(iv)(A). In addition, the final regulations provide that waived deductions are treated as non-deductible expenditures under section 705(a)(2)(B). *See* § 1.59A-3(c)(6)(iv)(B).

Further, the final regulations provide rules to conform the partner-level waiver with section 163(j). *See* § 1.59A-3(c)(6)(iv)(C). Specifically, the final regulations clarify that, when a partner waives a deduction that was taken into account by the partnership to reduce the partnership’s adjusted taxable income for purposes of determining the partnership-level section 163(j) limitation, the increase in the partner’s income resulting from the waiver is treated as a partner basis item (as defined in § 1.163(j)-6(b)(2)) for the partner, but not the partnership. Thus, the increase in the partner’s income resulting from the waiver is added to the partner’s section 163(j) limitation computation. § 1.59A-3(c)(6)(iv)(C). The partnership’s section 163(j) computations are not impacted by the partner’s waiver.

Another comment recommended that, if waiver of partnership deductions is permitted, the effect of the waiver should be reconciled with the centralized partnership audit regime enacted by the BBA in sections 6221 through 6241 (the “BBA audit procedures”). Under the BBA audit procedures, adjustments must be made at

the partnership level. Generally, the partnership is liable for an imputed underpayment computed on the adjustments unless the partnership elects to “push out” the adjustments to the partners from the year to which the adjustments relate (reviewed year partners). Sections 6221, 6225, 6226, and 6227.

The final regulations clarify that a partner may make the BEAT waiver election with respect to an increase in a deduction that is attributable to an adjustment made under the BBA audit procedures, but only if the partner is taking into account the partnership adjustments either because the partnership elects to have the partners take into account the adjustments under sections 6226 or 6227, or because the partner takes into account the adjustments as part of an amended return filed pursuant to section 6225(c)(2)(A). § 1.59A-3(c)(6)(iv)(D). If the partner makes the BEAT waiver election, the partner will compute its additional reporting year tax (as described in §301.6226-3) or the amount due under §301.6225-2(d)(2)(ii)(A), treating the waived amount as provided in § 1.59A-3(c)(6). The final regulations do not address the interaction of the BBA audit procedures and the BEAT more generally. As the BBA audit procedures continue to be implemented, the Treasury Department and the IRS will review the implementation and determine whether future BBA audit procedure guidance is required with respect to BEAT.

A comment observed that section 6222 generally requires a partner to treat a partnership item on its return consistently with the treatment of the item on the partnership return or otherwise to notify the IRS of this inconsistent treatment. This comment recommended that the final regulations coordinate and streamline the notification procedure under section 6222 and §301.6222-1 with the information required under proposed § 1.59A-3(c)(6)(i)(A) through (G).

The final regulations do not reflect this comment because the reporting by a partner of the partnership item that is waived pursuant to the procedures set forth in § 1.59A-3(c)(6)(ii)(B) is consistent with the reporting of the item for purposes of section 6222. After the election is made, the partnership-related item is being reported properly at the partner level, after taking

into account the partner's facts and circumstances and application of the Code and regulations to that item (that is, the waiver). The fact that an item is waived pursuant to § 1.59A-3(c)(6) does not constitute inconsistent reporting for purposes of section 6222 but is merely applying the Code and regulations to determine the taxability of that item. *See* §301.6222-1(a) (requiring a partner to treat partnership-related items "consistent with the treatment of such items on the partnership return in all respects, including the amount, timing, and characterization of such items"); *see generally* § 1.59A-3(c)(6)(ii)(B) (requiring a taxpayer to report certain information in connection with waived items, including the amount waived and the amount claimed).

H. Application of the BEAT Waiver Election to Consolidated Groups

A comment recommended that the final regulations clarify that waived deductions attributable to a consolidated group member are treated as noncapital, nondeductible expenses that decrease the tax basis in the member's stock for purposes of the stock basis rules in § 1.1502-32 to prevent the shareholder from subsequently benefiting from a waived deduction when disposing of the member's stock. The final regulations adopt this clarifying comment. *See* § 1.59A-3(c)(6)(iii)(A)(4).

I. Interaction of Waived Deductions with Other Regulations

The proposed regulations included specific references to provisions of the Code and regulations that are not affected by the BEAT waiver election in proposed § 1.59A-3(c)(6)(iii)(B). The proposed regulations also provided that waived deductions are taken into account as necessary to prevent a taxpayer from receiving the benefit of a waived deduction. § 1.59A-3(c)(6)(iii)(B)(7). No comments addressed this aspect of the proposed regulations. The final regulations retain these rules, which may apply when other deductible expenses are taken into account for other specific purposes of the Code because the item was an expense (rather than because the item was deducted), such as the fact that waived deductions are still taken

into account for purposes of determining the amount of the taxpayer's earnings and profits under § 1.59A-3(c)(6)(iii)(B)(6).

IV. Application of the BEAT to Partnerships

The 2019 final regulations set forth operating rules for applying the BEAT to partnerships. In general, the final regulations provide that a partnership is treated as an aggregate of its partners and, accordingly, deem certain transactions to have occurred at the partner level for BEAT purposes even though they may be treated as having occurred at the partnership level for other tax purposes. *See generally* § 1.59A-7.

A. Effectively Connected Income

Generally, the 2019 final regulations provide an exception (the "ECI exception") whereby a base erosion payment does not result from amounts paid or accrued to a foreign related party that are subject to tax as ECI. § 1.59A-3(b)(3)(iii). To qualify for the ECI exception, the taxpayer must receive a withholding certificate on which the foreign related party claims an exemption from withholding under section 1441 or 1442 because the amounts are ECI. The 2019 final regulations do not set out specific rules for applying the ECI exception to transactions involving partnerships. The preamble to the proposed regulations stated that the Treasury Department and the IRS are considering additional guidance to address (i) the treatment of a contribution by a foreign person to a partnership engaged in a U.S. trade or business, (ii) transfers of partnership interests by a foreign person and (iii) transfers of property by the partnership with a foreign person as a partner to a related U.S. person. REG-112607-19, 84 FR 67046, 67049 (December 6, 2019).

A comment generally supported applying an ECI exception to partnership transactions where the taxpayer is treated as making a base erosion payment as a result of a deemed transaction with a foreign related party, and where the foreign related party is subject to U.S. federal income tax on allocations of income from the partnership. The Treasury Department and the IRS generally agree with this comment

and have revised the final regulations in § 1.59A-3(b)(3)(iii)(C) to expand the ECI exception to apply to certain partnership transactions. The expanded ECI exception in § 1.59A-3(b)(3)(iii)(C) applies if the exception in § 1.59A-3(b)(3)(iii)(A) or (B) would have applied to the payment or accrual as characterized under § 1.59A-7(b) and (c) for purposes of section 59A (assuming any necessary withholding certificate were obtained).

Thus, for example, if a U.S. taxpayer purchases an interest in a partnership from a foreign related party, then under the general BEAT partnership rules for transfers of a partnership interest, this transaction is treated as a transfer by the foreign related party of a portion of the partnership assets to the U.S. taxpayer. *See* § 1.59A-7(c)(3). To the extent that these partnership assets are used or held for use in connection with the conduct of a trade or business within the United States, this situation is similar to a situation where the foreign related party directly holds the assets that produce ECI (for example, in a U.S. branch). In that analogous situation, an acquisition of those assets by the U.S. taxpayer from the foreign related party would have been eligible for the ECI exception reflected in § 1.59A-3(b)(3)(iii).

The ECI exception reflected in § 1.59A-3(b)(3)(iii)(C) also may apply in other situations, such as when (i) a U.S. taxpayer contributes cash and a foreign related party of the U.S. taxpayer contributes depreciable property to the partnership (*see* § 1.59A-7(c)(3)(iii)), (ii) a partnership with a partner that is a foreign related party of the taxpayer partner engages in a transaction with the taxpayer (*see* § 1.59A-7(c)(1)), or (iii) a partnership engages in a transaction with a foreign related party of a partner in the partnership (*id.*).

The general ECI exception reflected in § 1.59A-3(b)(3)(iii)(A) would not apply if a U.S. person purchased depreciable or amortizable property from a foreign related party and that property was not held in connection with a U.S. trade or business. Similarly, when a U.S. person is treated as purchasing the same depreciable or amortizable property from a foreign related party under § 1.59A-7(c)(3)(iii) because the foreign related party contributes that property to a partnership,

the ECI exception does not apply even though the property becomes a partnership asset after the transaction and the partnership uses the property in its U.S. trade or business.

To implement this addition, the final regulations include modified certification procedures similar to those set forth in § 1.59A-3(b)(3)(iii)(A) in order for the taxpayer to qualify for this exception. Specifically, the final regulations require a taxpayer to obtain a written statement from a foreign related party that is comparable to a withholding certification provided under § 1.59A-3(b)(3)(iii)(A), but which takes into account that the transaction is a deemed transaction under § 1.59A-7(b) or (c) rather than a transaction for which the foreign related party is required to report ECI. The taxpayer may rely on the written statement unless it has reason to know or actual knowledge that the statement is incorrect.

B. Treatment of Curative Allocations

The proposed regulations provided that if a partnership adopts the curative method of making section 704(c) allocations under § 1.704-3(c), the allocation of income to the contributing partner in lieu of a deduction allocation to the non-contributing partner is treated as a deduction for purposes of section 59A. Proposed § 1.59A-7(c)(5)(v). A comment expressed support for the rule and recommended that the Treasury Department and the IRS also clarify that base erosion tax benefits include curative allocations of an item of deduction attributable to a base erosion payment. The Treasury Department and the IRS believe that the proposed regulations were already clear in this regard. Therefore, the final regulations retain § 1.59A-7(c)(5)(v) along with an example that illustrates when curative allocations are treated as base erosion tax benefits; the final regulations also clarify that curative allocations that arise under section 704(c) as a result of a revaluation are treated in a similar manner.

C. Partnership Anti-Abuse Rules - Derivatives Involving Partnerships

Section 1.59A-3(b)(3)(ii) provides an exception from base erosion payment

status for qualified derivative payments. Section 1.59A-6(d)(1) defines a derivative for purposes of the QDP rules as a contract whose value is determined by reference to one or more of the following: (1) any shares of stock in a corporation, (2) any evidence of indebtedness, (3) any actively traded commodity, (4) any currency, or (5) any rate, price, amount, index, formula, or algorithm. Proposed § 1.59A-9(b)(5) provides an anti-abuse rule relating to derivatives on partnership interests and partnership assets. Under this proposed rule, if a taxpayer acquires a derivative on a partnership interest or partnership assets with a principal purpose of eliminating or reducing a base erosion payment, then the taxpayer is treated as having a direct interest in the partnership interest or partnership asset (instead of a derivative interest) for purposes of applying section 59A.

A comment recommended that the regulations clarify the interaction of the anti-abuse rule relating to derivatives on partnership assets with the QDP exception that applies with respect to certain derivatives. The final regulations adopt this comment and provide that the partnership anti-abuse rule for derivatives does not apply when a payment with respect to a derivative on a partnership asset qualifies for the QDP exception. § 1.59A-9(b)(5).

D. Other Issues

Proposed § 1.6031(a)-1(b)(7) stated:

If a foreign partnership is not required to file a partnership return and the foreign partnership has made a payment or accrual that is treated as a base erosion payment of a partner as provided in § 1.59A-7(b)(2), a person required to file a Form 8991 (or successor) who is a partner in the partnership must provide the information necessary to report any base erosion payments on Form 8991 (or successor) or the related instructions. This paragraph does not apply to any partner described in § 1.59A-7(b)(4).

The cross-references contained in this regulation, § 1.59A-7(b)(2) and § 1.59A-7(b)(4), do not exist. The final regulations clarify which partners are intended to be excluded from the application of proposed § 1.6031(a)-1(b)(7). See §

1.6031(a)-1(b)(7). Section 1.6031(a)-1(b)(7) is also revised to make certain clarifying changes.

Finally, § 1.59A-9(b)(6) is revised to make certain clarifying changes.

V. Anti-abuse Rules of § 1.59A-9 for Basis Step-up Transactions

Section 59A(d)(2) generally defines a base erosion payment to include an amount paid or accrued to a foreign related party in connection with the acquisition of depreciable or amortizable property. However, § 1.59A-3(b)(3)(viii) provides an exception to the definition of a base erosion payment for certain amounts transferred to or exchanged with a foreign related party in a transaction described in sections 332, 351, 355, and 368 (the “specified nonrecognition transaction exception”).

The specified nonrecognition transaction exception was adopted in the 2019 final regulations in response to comments to proposed regulations issued in 2018 that argued that the depreciable or amortizable assets acquired by a domestic corporation in a nonrecognition transaction should not be taken into account for purposes of the BEAT because nonrecognition transactions generally result in carryover tax basis to the acquiring corporation. TD 9885, 84 FR 66968, 66977. These comments also stated that if that recommendation were to be adopted, an anti-abuse rule also could be adopted to prevent taxpayers from undermining this policy rationale for the specified nonrecognition transaction exception by engaging in basis step-up transactions immediately before an inbound nonrecognition transaction. The 2019 final regulations generally adopted the approach recommended by comments, including adopting a specific targeted anti-abuse rule in § 1.59A-9(b)(4). That rule provides that if a transaction, plan, or arrangement has a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in a specified nonrecognition transaction, the nonrecognition exception of § 1.59A-3(b)(3)(viii)(A) will not apply to the nonrecognition transaction. Additionally, § 1.59A-9(b)(4) contains an irrebuttable presumption that a transaction, plan, or arrangement between re-

lated parties that increases the adjusted basis of property within the six-month period before the taxpayer acquires the property in a specified nonrecognition transaction has a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in a nonrecognition transaction.

Taxpayers have expressed concern about the breadth of the anti-abuse rule. A comment stated that the anti-abuse rule can create a “cliff effect” whereby a minimal amount of pre-transaction basis step-up could disqualify an entire transaction that would have otherwise qualified for the specified nonrecognition transaction exception. The comment recommended that the anti-abuse rule exclude transactions with a relatively small amount of basis step-up or provide taxpayers with an election to forego the basis step-up.

Section 1.59A-9(b)(4) has been revised to adopt this comment. First, the anti-abuse rule now provides that when the rule applies, its effect is to turn off the application of the specified nonrecognition transaction exception only to the extent of the basis step-up amount. This revision addresses the comment’s concern regarding the cliff effect of the rule.

Second, § 1.59A-9(b)(4) has been revised to clarify that the transaction, plan, or arrangement with a principal purpose of increasing the adjusted basis of property must also have a connection to the acquisition of the property by the taxpayer in a specified nonrecognition transaction. This change is made because the Treasury Department and the IRS understand that some taxpayers interpreted the prior version of the rule to potentially apply to certain basis step-up transactions (for example, a qualified stock purchase for which an election is made under section 338(g)), even if that basis step-up transaction had no factual connection with a later specified nonrecognition transaction (for example, the section 338(g) transaction occurred many years before the BEAT was enacted, but the property still has a stepped-up basis that is being depreciated or amortized when the subsequent specified nonrecognition transaction occurs). Sections 1.59A-9(c)(11) (*Example 10*) and 1.59A-9(c)(12) (*Example 11*) have also been revised to reflect these changes.

VI. Possible Future Guidance Concerning the QDP Reporting Requirements

The preamble to the proposed regulations indicated that comments to the proposed regulations were required to be received by February 4, 2020. REG-112607-19, 84 FR 67046 (December 6, 2019). A comment was submitted after this date that recommended that the Treasury Department address the interaction of the QDP exception, the BEAT netting rule in § 1.59A-2(e)(3)(iv) (with respect to positions for which a taxpayer applies a mark-to-market method of accounting for U.S. federal income tax purposes), and the QDP reporting requirements in § 1.59A-6 and § 1.6038A-2(b)(7)(ix) – each in the 2019 final regulations. The comment recommended that the asserted ambiguities be addressed in revised final regulations, a revenue procedure or another type of written authoritative guidance. The Treasury Department and the IRS are studying this submission and considering whether future guidance may be appropriate.

Applicability Date

These final regulations generally apply to taxable years beginning on or after October 9, 2020. The rules in §§ 1.59A-7(c)(5)(v) and (g)(2)(x), and 1.59A-9(b)(5) and (6) apply to taxable years ending on or after December 2, 2019.

Taxpayers may apply these final regulations in their entirety for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply these regulations in their entirety for all subsequent taxable years. See section 7805(b)(7). Alternatively, taxpayers may apply only § 1.59A-3(c)(5) and (6) for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply § 1.59A-3(c)(5) and (6) in their entirety for all subsequent taxable years. Taxpayers may also rely on §§ 1.59A-2(c)(2)(ii) and (c)(4) through (6), and 1.59A-3(c)(5) and (c)(6) of the proposed regulations in their entirety for taxable years beginning after December 31, 2017, and before October 9, 2020.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

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, of reducing costs, of harmonizing rules, and of promoting flexibility. The Executive Order 13771 designation for this regulation is regulatory.

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

A. Background

The Tax Cuts and Jobs Act of 2017 (the “Act”) added new section 59A, which imposes a Base Erosion and Anti-Abuse Tax (“BEAT”) on certain deductions paid or accrued to foreign related parties. By taxing such payments, the BEAT “aims to level the playing field between U.S. and foreign-owned multinational corporations in an administrable way.” Senate Committee on Finance, Explanation of the Bill, S. Prt. 115-20, at 391 (November 22, 2017).

The tax is levied only on corporations with substantial gross receipts (a determination referred to as the “gross receipts test”) and for which the relevant deductions are three percent or higher (two percent or higher in the case of certain banks or registered securities dealers) of the corporation’s total deductions (with certain exceptions), a determination referred to as the “base erosion percentage test.” The applicable percentage in the base erosion percentage test is referred to in these Spe-

cial Analyses as the base erosion threshold.

A taxpayer that satisfies both the gross receipts test and the base erosion percentage test is referred to as an applicable taxpayer. A taxpayer is not an applicable taxpayer, and thus does not have any BEAT liability, if its base erosion percentage is less than the base erosion threshold.

Additional features of the BEAT also enter its calculation. The BEAT operates as a minimum tax, so an applicable taxpayer is only subject to additional tax under the BEAT if the tax at the BEAT rate multiplied by the taxpayer's modified taxable income exceeds the taxpayer's regular tax liability, reduced by certain credits. Because of this latter provision, the BEAT formula has the effect of imposing the BEAT on the amount of those tax credits. In general, tax credits are subject to the BEAT except the research credit under section 41 and a portion of low income housing credits, renewable electricity production credits under section 45, and certain investment tax credits under section 46. Notably, this means that the foreign tax credit is currently subject to the BEAT. In taxable years beginning after December 31, 2025, all tax credits are subject to the BEAT.

On December 6, 2019, the Treasury Department and the IRS published final regulations under sections 59A, 383, 1502, 6038A, and 6655 (the "2019 final regulations") and also published proposed regulations ("proposed regulations"), which are being finalized here.

B. Need for the final regulations

Section 59A does not explicitly state whether an amount that is permitted as a deduction under the Code or regulations but that is not claimed as a deduction on a taxpayer's tax return is potentially a base erosion tax benefit for purposes of the BEAT and the base erosion percentage test. Comments recommended that the Treasury Department and the IRS clarify the treatment of amounts that are allowable as a deduction but not claimed as a deduction on a taxpayer's tax return. Regulations are needed to respond to these comments and to clarify the treatment of these amounts under section 59A, including with respect to partnership items and

reinsurance payments. Regulations are also needed to clarify certain aspects of the rules set forth in the 2019 final regulations relating to how a taxpayer determines its aggregate group for purposes of determining gross receipts and the base erosion percentage, and how the BEAT applies to partnerships.

C. Overview

These final regulations ("these regulations" or "the regulations") provide taxpayers an election to waive deductions that would otherwise be taken into account in determining whether the taxpayer is an applicable taxpayer subject to the BEAT. The regulations also permit waiver of some reinsurance items that are also subject to the BEAT. These provisions are analyzed in part D of these Special Analyses.

These regulations also include modifications to the rules set forth in the 2019 final regulations relating to how a taxpayer determines its aggregate group for purposes of determining gross receipts and the base erosion percentage, and how the BEAT applies to partnerships. The regulations further address, in response to comments, technical issues that apply when a partner in a partnership elects to waive deductions, and when reinsurance items are waived – issues that were not addressed in the proposed regulations. These provisions are not expected to result in any meaningful changes in taxpayer behavior relative to the no-action baseline or alternative regulatory approaches and are not assessed in these Special Analyses.

The proposed regulations solicited comments on the economic effects of the election to waive deductions and more generally of the proposed regulations. No such comments were received.

D. Economic Analysis

1. Baseline

In this analysis, the Treasury Department and the IRS assess the benefits and costs of these final regulations compared to a no-action baseline that reflects anticipated Federal income tax-related behavior in the absence of these regulations.

2. Economic Effects of the Election to Waive Deductions

a. Background and Alternatives Considered

Section 59A does not explicitly state whether an amount that is permitted as a deduction under the Code or regulations but that is not claimed as a deduction on the taxpayer's tax return is potentially a base erosion tax benefit for the purposes of the base erosion percentage test. A taxpayer may find waiving certain deductions advantageous if the waived deductions lower the taxpayer's base erosion percentage below the base erosion threshold, thus making section 59A inapplicable to the taxpayer. Comments to prior proposed regulations recommended that the Treasury Department and the IRS clarify the treatment of allowable amounts that are not claimed as a deduction on the taxpayer's tax return for purposes of section 59A.

To address concerns about the treatment of these amounts permitted as deductions under law, the Treasury Department and the IRS considered two alternatives: (1) provide that all deductions that could be properly claimed by a taxpayer for the taxable year are taken into account for purposes of the base erosion percentage test (and for other purposes of the BEAT) even if a deduction is not claimed on the taxpayer's tax return (the "alternative regulatory approach"); or (2) provide that an allowable deduction that a taxpayer does not claim on its tax return is not taken into account in the base erosion percentage test or for other purposes of the BEAT, provided that certain procedural steps are followed. These regulations adopt the latter approach.

Under the alternative regulatory approach, base erosion payments allowable as deductions but not claimed by a taxpayer would nonetheless be taken into account in the base erosion percentage. Thus, a taxpayer could not avoid satisfying the base erosion percentage test by not claiming certain deductions. Under these regulations, base erosion payments allowable as deductions but waived by a taxpayer are not taken into account in the base erosion percentage test, assuming certain procedural steps are followed. The waived deductions are waived for all U.S. federal

income tax purposes (with certain exceptions listed in the regulations) and thus, for example, the deductions are also not allowed for regular income tax purposes. If the taxpayer is not an applicable taxpayer because the taxpayer waives deductions so as not to satisfy the base erosion percentage test, the taxpayer may continue to claim deductions for base erosion payments that are not waived, provided these deductions would otherwise be allowed.

b. Example

Consider a U.S.-parented multinational enterprise that satisfies the gross receipts test and that is not a bank or registered securities dealer. The U.S. corporation has gross income from domestic sources of \$1000x and also has a net global intangible low-taxed income (“GILTI”) inclusion of \$500x.² The taxpayer has \$870x of deductions pertinent to this example that are not base erosion tax benefits and \$30x of deductions that are base erosion tax benefits. It is also assumed that the amount of foreign tax credits permitted under section 904(a) is \$105x. This taxpayer’s regular U.S. taxable income is \$600x (\$1000x + \$500x - \$870x - \$30x), its regular U.S. tax rate is 21.0 percent, and its regular U.S. tax liability is \$21x (\$600x X 21% = \$126x, less foreign tax credits of \$105x (\$126x - \$105x)).

Under the alternative regulatory approach, the taxpayer is an applicable taxpayer because its base erosion percentage is 3.33 percent ($\$30x / \$900x$), which is greater than the three percent base erosion threshold. Because the taxpayer is subject to the BEAT, it must further compute its modified taxable income, which is \$630x — its regular U.S. taxable income (\$600x) plus its base erosion tax benefits (\$30x). The taxpayer determines its base erosion minimum tax amount as the excess of the BEAT rate (10 percent) multiplied by its modified taxable income (\$630, thus yielding a base erosion minimum tax amount of $\$63x = \$630x \times 10\%$) over its

regular U.S. tax liability of \$21x, which is equal to \$42x ($\$63x - \$21x$). In this example the total U.S. tax bill is \$63x (\$21x of regular tax and \$42x of BEAT).

Under these regulations, this taxpayer would have the option to waive all or part of its deductions that are base erosion payments; this is potentially advantageous to the taxpayer if it allows the taxpayer’s base erosion percentage to fall below the base erosion threshold. Specifically, the taxpayer could waive \$3.10x of its deductions that are base erosion payments, yielding a base erosion percentage below the three percent base erosion threshold (base erosion tax benefits = $\$26.90x$ ($\$30x - \$3.10x$); base erosion percentage = $\$26.90x / (\$870x + \$26.90x) = 2.99\%$). After taking into account this waiver, the taxpayer’s regular taxable income would increase to \$603.10x ($\$1000x + \$500x - \$870x - \$26.90x$), and its regular tax liability would increase to \$21.65x ($\$603.10x \times 21\% = \126.65 , less foreign tax credits of \$105x = \$21.65x).³ The waiver is valuable to this taxpayer because its tax bill in this simple example is lower by \$41.35x ($\$63x - \$21.65x$).

This example shows the difference in tax liability caused by allowing deductions to be waived and thus, the difference in tax liability between these regulations and the alternative regulatory approach. Part D.2.c of these Special Analyses discusses the behavioral incentives and economic effects that can result from this tax treatment.

c. Economic Effects of the Election to Waive Deductions

These regulations effectively allow a taxpayer to make payments that would be base erosion payments without becoming an applicable taxpayer and thus subject to the BEAT. Thus, this provision reduces the effective tax on base erosion payments for some taxpayers, relative to the alternative regulatory approach. Because of this reduction, these regulations may lead to a

higher amount of base erosion payments than under the alternative regulatory approach.

The Treasury Department projects, based on a standard economic model, that any such higher amount of base erosion payments under these regulations would come from those taxpayers who, under the alternative regulatory approach, would not be applicable taxpayers but would be close to being applicable taxpayers; that is, the taxpayers who would potentially change behavior would be those taxpayers who, under the alternative regulatory approach, would have a base erosion percentage that was close to but below the base erosion threshold. No additional base erosion payments are projected under this model to come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.⁴

To see the logic behind this claim, consider an applicable taxpayer under the alternative regulatory approach with base erosion payments of \$Y. If this taxpayer were to increase its base erosion payments by \$10 and reduce its non-base erosion payments by \$10 (that is, it has substituted base erosion payments for non-base erosion payments), its tax bill would generally increase by \$1. The fact that this taxpayer chose base erosion payments of \$Y rather than \$Y+10 suggests that this substitution would be worth less than \$1 to the taxpayer. The substitution is not worth the increased tax. Next consider this taxpayer under these regulations. If it elects to waive sufficient deductions such that it is not an applicable taxpayer, then the marginal increase in its tax bill from the hypothesized substitution is \$2.10. Thus, if this increase in base erosion payments (and substitution away from non-base erosion payments) is not worthwhile to the taxpayer under the alternative regulatory approach, it will not be worthwhile under these regulations. This example suggests that to the extent that there is any increase in base erosion payments under these regulations (and substitution away from non-

²For simplification of this example, the \$500x GILTI income is presented as the net of the global intangible low-tax income amount of the domestic corporation under section 951A, plus the section 78 gross up amount for foreign taxes, less the GILTI deduction under section 250(a)(1)(B). The deduction under section 250(a)(1)(B) is not taken into account in determining the base erosion percentage. See section 59A(c)(4)(B)(i).

³Although the waiver increases the taxpayer’s regular taxable income, the taxpayer’s gross income (in the context of this example) is unchanged. Thus, only the tax liability needs to be compared across the regulatory approaches to determine whether the taxpayer would benefit from waiving deductions.

⁴To the extent that this model does not capture all possible taxpayer circumstances, the Treasury Department recognizes that there may be some additional base erosion payments that come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.

base erosion payments), it generally will not come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.

The example further suggests that any change in behavior will instead generally come from those taxpayers that would not be applicable taxpayers under the alternative regulatory approach. These taxpayers would be able, under these regulations, to take on activities that increase their base erosion payments but, by waiving all or part of the deduction for these activities, avoid crossing the base erosion threshold. The Treasury Department projects that this is the set of taxpayers that will be the primary source of any economic effects arising from these regulations. To the extent that this model does not capture all possible taxpayer circumstances, the Treasury Department recognizes that there may be some additional base erosion payments that come from taxpayers that would be applicable taxpayers under the alternative regulatory approach.

As a result of the ability to waive deductions in these regulations, these taxpayers may change business behavior in two possible ways relative to the alternative regulatory approach. First, these businesses may expand economic activities in the United States even if those activities result in payments to foreign related parties (i.e., base erosion payments). For example, under the alternative regulatory approach a multinational enterprise may decide not to open an office or manufacturing plant in the United States if that incremental activity also resulted in incremental base erosion payments that would cause the taxpayer to become an applicable taxpayer. Under these regulations, this business can expand its activities in the U.S. and avoid becoming an applicable taxpayer provided it waived sufficient deductions to stay below the base erosion threshold. These activities would be accompanied by an increase in base erosion payments.

Second, businesses already operating in the United States may structure a greater proportion of their transactions as base erosion payments under these regulations relative to the alternative regulatory approach. Under the alternative regulatory approach, a business might conduct

its transactions through unrelated parties rather than with a foreign related party so that its base erosion percentage would remain below the base erosion threshold. Under these regulations, this business could instead use a foreign related party (thus, the transaction would generally be a base erosion payment) rather than an unrelated party for these transactions, without paying the BEAT, again provided it waived sufficient deductions to stay below the base erosion threshold.

In each of these cases, under the standard economic model a business adopting these strategies would be presumed to accrue a non-tax, economic benefit from using a foreign related party rather than an unrelated party to conduct this aspect of its business. Under these final regulations, there would be no U.S. tax-related benefit associated with transacting with a foreign related party and thus any decisions made by a business to make a base erosion payment would occur because of the economic advantage it provides to the business, rather than that payment being avoided, diverted or otherwise distorted because it would result in the taxpayer becoming an applicable taxpayer subject to the BEAT. This economic advantage might arise, for example, because the business has a closer relationship with the foreign related party and its transactions with the foreign related party provide enhanced managerial control. In these circumstances, these activities would generally be beneficial to the U.S. economy.

Although the standard economic model projects an increase in base erosion payments and a benefit to the U.S. economy under these regulations relative to the alternative regulatory approach, it does not yield clear implications for the economic value of these payments. An inference about the marginal value of a base erosion payment depends on the marginal tax incurred by base erosion payments near the base erosion threshold, which in turn depends on (i) how close the taxpayer would be to the threshold; (ii) the quantity of its base erosion payments that are below the base erosion threshold and subject to tax if the base erosion threshold is exceeded; and (iii) other factors affecting the potential BEAT liability *such as the additional*

BEAT tax liability relative to non-BEAT tax liability in situations when significant tax credits are also subject to BEAT (see generally, part I.A of this Special Analyses section).

Because of these factors, the difference in the non-tax value to businesses of a marginal base erosion payment between these regulations and alternative regulatory approach is complex and cannot be readily inferred.

In summary, for taxpayers who elect to waive deductions under these regulations, the Treasury Department and the IRS expect that relative to the alternative regulatory approach, these regulations would tend to:

- Reduce tax costs of additional economic activity in the United States by those taxpayers in the situation where additional economic activity in the United States would tend to increase base erosion payments;
- Reduce tax-related incentives for otherwise economically inefficient business, contractual or accounting changes designed to avoid the taxpayer being an applicable taxpayer;
- Continue to fulfill the general intent and purpose of the statute by not providing tax incentives for certain large corporations to make deductible payments to foreign related parties in excess of 3 percent of the taxpayer's deductions; and
- Reduce the number of taxpayers that are applicable taxpayers and the overall amount of BEAT collected. This revenue effect is likely to be offset to some degree by the fact that some taxpayers are likely to elect to waive allowable deductions.

The Treasury Department and the IRS project that the final regulations will have economic effects greater than \$100 million per year (\$2020) relative to the no-action baseline. This determination is based on the substantial size of the businesses potentially affected by these regulations (3-year average annual gross receipts of \$500 million or above) and the general responsiveness of business activity to effective tax rates,⁵ one component of which is the deductibility of base erosion payments. Based on these two magnitudes,

⁵See E. Zwick and J. Mahon, "Tax Policy and Heterogeneous Investment Behavior," at *American Economic Review* 2017, 107(1): 217-48 and articles cited therein.

even modest changes in the deductibility of base erosion tax benefits (and in the certainty of that deductibility) provided by the final regulations, relative to the no-action baseline, can be expected to have annual effects greater than \$100 million (\$2020). The Treasury Department and the IRS have not produced a more precise estimate of the economic consequences of these regulations relative to the alternative regulatory approach. The economic effects of these regulations depend on (i) the number of taxpayers that would be close to and below the base erosion threshold under the alternative regulatory approach; (ii) the increase in the quantity of base erosion payments they would have under these regulations relative to the alternative regulatory approach; and (iii) the economic consequences of those increased base erosion payments. Items (ii) and (iii) are particularly difficult to estimate with any reasonable precision in part because they involve economic activities, including potential new economic activity in the United States, that cannot be readily inferred from existing data or models available to the Treasury Department and the IRS.

The Treasury Department recognizes that taxpayers may incur compliance costs related to deciding whether to waive deductions and ensuring that procedural rules are followed but projects that any such compliance costs will likely be small because the accounting required for the relevant deductions is essentially the same under both these regulations and the alternative regulatory approach. Under both these regulations and the alternative regulatory approach, an applicable taxpayer would have to calculate its BEAT liability. The only additional step a taxpayer that otherwise would be an applicable taxpayer may choose to take under these regulations is to calculate its tax liability with the waiver of certain deductions (all of which the taxpayer would already have documented) in order to avoid being an applicable taxpayer. The taxpayer would make this additional calculation to consider whether waiver of those deductions would result in a lower tax liability. Because these costs are likely to be relatively small, the Treasury Department and the IRS have not estimated the change in compliance costs of this waiver relative to the alternative regulatory approach.

d. Waiver of Reinsurance Payments

The BEAT waiver election in the proposed regulations generally allowed the waiver of deductions but did not include the waiver of other base erosion tax benefits that were not technically deductions. The term “base erosion tax benefits” includes certain reinsurance payments that are treated under the Code as reductions to gross income rather than deductions and thus, under the proposed regulations, would not be eligible for a waiver. Because a reduction to income is generally economically similar to a deduction, in response to comments, the Treasury Department and the IRS have determined that the policy rationale for providing the BEAT waiver election also applies to insurance-related base erosion payments. Thus, these regulations further provide for the waiver of amounts treated as reductions to gross premiums and related payments that would otherwise be base erosion tax benefits within the definition of section 59A(c)(2)(A)(iii).

This provision will generally lead to an increase in reinsurance payments that are base erosion payments, relative to the alternative regulatory approach. The Treasury Department projects that because these payments are economically similar to other payments that are allowed a waiver, this provision will treat similar income similarly and thereby improve the performance of the U.S. economy relative to a regulatory approach of not allowing a waiver for certain reinsurance items while allowing such a waiver for other deductions.

The Treasury Department and the IRS have not estimated the increase in reinsurance payments that are base erosion payments that is likely to result under these regulations, relative to the alternative regulatory approach, because currently available tax data include only (net) premiums and do not separately record reinsurance transactions. The Treasury Department and the IRS further have not estimated the economic consequences of taxpayers substituting reinsurance payments that are base erosion payments for reinsurance payments that would not be base erosion payments because the Treasury Department and the IRS do not have readily available models that could assess this value.

e. Number of Affected Taxpayers

These regulations affect all corporate taxpayers that satisfy the gross receipts test and base erosion percentage test and have base erosion payments. The Treasury Department and the IRS project that approximately 2,200 taxpayers are affected by these regulations. This estimate is based on the number of returns in the IRS’s Statistics of Income (SOI) corporate sample as of July 28, 2020, that are recorded as having Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts*, attached and that reported gross receipts of \$500 million or above in tax year 2018. These attachments have not yet been verified and could include blanks, duplicates, or forms that do not properly contain information related to the BEAT. Because this sample is preliminary, these returns have not yet been weighted for the extent to which they represent the population of corporate tax returns. This count includes paper returns.

These data show that 5,911 returns have Form 8991 attached. Of these, 2,222 tax returns show gross receipts of \$500 million or more and 3,689 have gross receipts below \$500 million in 2018. Although the BEAT test for applicable taxpayer status depends on the average of gross receipts over a three-year period, these tax data have not yet been linked to previous years’ data and thus do not reflect the 3-year average of gross receipts. Of these 5,911 tax returns, 393 returns paid the BEAT tax.

II. Paperwork Reduction Act

The collections of information in these final regulations with respect to section 59A are in §§ 1.59A-3(b)(3)(iii)(C), 1.59A-3(c)(6), and 1.6031(a)-1(b)(7). These final regulations retain the collections of information in the proposed regulations, with the addition of the collection of information in § 1.59A-3(b)(3)(iii)(C).

The collection of information in § 1.59A-3(b)(3)(iii)(C) permits an amount paid or accrued by a taxpayer to a partnership to be eligible for the base erosion payment exception with respect to effectively connected income. This exception applies to any amount treated as paid or accrued to a foreign related party under § 1.59A-7(b) or (c) to the extent that the ex-

ception for effectively connected income provided in § 1.59A-3(b)(3)(iii)(A) would have applied if the amount paid or accrued had been made directly by the taxpayer to the foreign related party. To be eligible for this exception, a foreign related party or partnership must certify to the taxpayer that a payment to a partnership would have been effectively connected income if paid directly to the foreign related party. Section 1.59A-3(b)(3)(iii)(C) was added in response to comments. The collection of information associated with this addi-

tion allows a taxpayer to verify that the recipient of an amount paid or accrued to a foreign related party is eligible for the exception in § 1.59A-3(b)(3)(iii)(C). The IRS may use this information to ensure compliance with § 1.59A-3(b)(3)(iii)(C). For purposes of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) (“PRA”), the reporting burden associated with § 1.59A-3(b)(iii)(C) will be reflected in the PRA submission associated with Form 8991 (see chart at the end of this part II of this Special Analyses section for the

status of the PRA submission for Form 8991). The estimated number of respondents for the reporting burden associated with § 1.59A-3(b)(3)(iii)(C) is based on the number of taxpayers who filed a Form 1120-F with Line Y(1) (“Did a partnership allocate to the corporation a distributive share of income from a directly owned partnership interest, any of which is ECI or treated as ECI by the partnership or the partner?”) checked “yes”. As provided below, the IRS estimates the number of affected filers to be approximately 6,000.

New	Revision of existing form	Number of respondents (estimate based on tax filings for taxable years 2018)
Y	N	6,000

As explained in the preamble to the proposed regulations, the collection of information in § 1.59A-3(c)(6) relates to an election to waive deductions allowed under the Code. The election to waive deductions is made by a taxpayer on its original or amended income tax return. A taxpayer makes the election on an annual basis by completing Form 8991, or as provided in applicable instructions. The instructions for Form 8991 currently describe how a taxpayer may make this election. The Form 8991 for the 2020 taxable year will incorporate this election.

As explained in the preamble to the proposed regulations, the collection of information in § 1.6031(a)-1(b)(7) requires a partner in a foreign partnership that: (1) is not required to file a partnership return and (2) has made a payment or accrual that is treated as a base erosion payment of a partner under § 1.59A-7(c), to provide the information necessary to report any base erosion payments on Form 8991. The IRS intends that this information will be collected by completing Form 8991.

The IRS is contemplating making revisions to Form 1065, Schedule K, and Schedule K-1 to take these final regulations into account, including through the proposed draft Schedules K-2 and K-3. In connection with the release of draft forms, the IRS invited comments from affected stakeholders.

For purposes of the Paperwork Reduction Act, the reporting burden associated with the collections of information with respect to section 59A will be reflected in the Paperwork Reduction Act Submission associated with Form 8991 (OMB control number 1545-0123).

The current status of the Paperwork Reduction Act submissions related to the BEAT is provided in the following table. The BEAT 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 3.344 billion hours and total estimated mon-

etized costs of \$61.558 billion (\$2019). 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 BEAT requirements. These numbers are therefore unrelated to the future calculations needed to assess the burden imposed by the final regulations. The Treasury Department and IRS urge readers to recognize that these numbers are duplicates and to guard against overcounting the burden that international tax provisions imposed prior to the Act. No burden estimates specific to the final 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 final regulations. In addition, when available, drafts of IRS forms are posted for comment at www.irs.gov/draftforms.

Form	Type of Filer	OMB Number(s)	Status
Form 8991	Business (NEW Model)	1545-0123	Approved by OIRA through 1/31/2021.
Link: https://www.govinfo.gov/content/pkg/FR-2019-12-19/pdf/2019-27297.pdf#page=1			

	New	Revision of existing form	Number of respondents (2018, estimated)
Form 8991	Y		6,000

The number of respondents in the Related New or Revised Tax Forms table was estimated by Treasury’s Office of Tax Analysis based on the number of returns in the IRS’s Statistics of Income (SOI) corporate sample as of July 28, 2020, that are recorded as having Form 8991 attached and that reported gross receipts of \$500 million or above in tax year 2018. Only certain large corporate taxpayers with gross receipts of at least \$500 million are expected to file this form.

III. Regulatory Flexibility Act

It is hereby certified that these 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). This certification is based on the fact that the BEAT and these regulations affect only aggregate groups of corporations with average annual gross receipts of at least \$500 million and that also make payments to foreign related parties in excess of the base erosion percentage test (that is, 3 percent or more of their deductible payments are to foreign related parties). Generally, only large businesses both have substantial gross receipts and make a significant portion of their deductible payments to foreign related parties. The \$500 million threshold for the gross receipts test is greater than any Small Business Administration size standard that is based on annual gross receipts. See generally 13 CFR part 121.

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

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires

that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. This rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

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

VI. Congressional Review Act

The Administrator of the Office of Information and Regulatory Affairs of the OMB has determined that this Treasury decision is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 *et seq.*) (“CRA”). Under section 801(3) of the CRA, a major rule generally takes effect 60 days after the rule is published in the Federal Register. Accordingly, the Treasury Department and IRS are adopting these final regulations with the delayed effective date generally prescribed under the CRA.

Drafting Information

The principal authors of these final regulations are Sheila Ramaswamy, Karen Walny, and Azeka Abramoff of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

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 1.59A-0 is revised to read as follows:

§ 1.59A-0 Table of contents.

This section contains a listing of the headings for §§ 1.59A-1, 1.59A-2, 1.59A-3, 1.59A-4, 1.59A-5, 1.59A-6, 1.59A-7, 1.59A-8, 1.59A-9, and 1.59A-10.

§ 1.59A-1 Base erosion and anti-abuse tax.

- (a) Purpose.
- (b) Definitions.
 - (1) Aggregate group.
 - (2) Applicable section 38 credits.
 - (3) Applicable taxpayer.
 - (4) Bank.
 - (5) Base erosion and anti-abuse tax rate.
 - (6) Business interest expense.
 - (7) Deduction.
 - (8) Disallowed business interest expense carryforward.
 - (9) Domestic related business interest expense.
 - (10) Foreign person.
 - (11) Foreign related business interest expense.
 - (12) Foreign related party.

- (13) Gross receipts.
- (14) Member of an aggregate group.
- (15) Registered securities dealer.
- (16) Regular tax liability.
- (17) Related party.
 - (i) In general.
 - (ii) 25-percent owner.
 - (iii) Application of section 318.
- (18) TLAC long-term debt required amount.
- (19) TLAC securities amount.
- (20) TLAC security.
- (21) Unrelated business interest expense.

§ 1.59A-2 Applicable taxpayer.

- (a) Scope.
- (b) Applicable taxpayer.
- (c) Aggregation rules.
 - (1) In general.
 - (2) Aggregate group determined with respect to each taxpayer.
 - (i) In general.
 - (ii) Change in the composition of an aggregate group.
 - (3) Taxable year of members of an aggregate group.
 - (4) Periods before and after a corporation is a member of an aggregate group.
 - (i) In general.
 - (ii) Deemed taxable year-end.
 - (iii) Items allocable to deemed taxable years before and after deemed taxable year-end.
 - (5) Short taxable year.
 - (i) Short period of the taxpayer.
 - (A) In general.
 - (B) Determining the gross receipts and base erosion percentage of the aggregate group of a taxpayer for a short period.
 - (ii) Short period of a member of the taxpayer's aggregate group.
 - (A) Multiple taxable years of a member of the taxpayer's aggregate group comprised of more than 12 months.
 - (B) Short period or periods of a member of the taxpayer's aggregate group comprised of fewer than 12 months from change in taxable year.
 - (iii) Anti-abuse rule.
 - (6) Treatment of predecessors.
 - (i) In general.
 - (ii) No duplication.
 - (7) Partnerships.
 - (8) Transition rule for aggregate group members with different taxable years.

- (9) Consolidated groups.
 - (d) Gross receipts test.
 - (1) Amount of gross receipts.
 - (2) Taxpayer not in existence for entire three-year period.
 - (3) Gross receipts of foreign corporations.
 - (4) Gross receipts of an insurance company.
 - (5) Reductions in gross receipts.
 - (e) Base erosion percentage test.
 - (1) In general.
 - (2) Base erosion percentage test for banks and registered securities dealers.
 - (i) In general.
 - (ii) Aggregate groups.
 - (iii) De minimis exception for banking and registered securities dealer activities.
 - (3) Computation of base erosion percentage.
 - (i) In general.
 - (ii) Certain items not taken into account in denominator.
 - (iii) Effect of treaties on base erosion percentage determination.
 - (iv) Amounts paid or accrued between members of a consolidated group.
 - (v) Deductions and base erosion tax benefits from partnerships.
 - (vi) Mark-to-market positions.
 - (vii) Reinsurance losses incurred and claims payments.
 - (viii) Certain payments that qualify for the effectively connected income exception and another base erosion payment exception.
 - (f) Examples.
 - (1) Example 1: Mark-to-market.
 - (i) Facts.
 - (ii) Analysis.
 - (2) Example 2: Member leaving an aggregate group.
 - (i) Facts.
 - (ii) Analysis.

§ 1.59A-3 Base erosion payments and base erosion tax benefits.

- (a) Scope.
- (b) Base erosion payments.
 - (1) In general.
 - (2) Operating rules.
 - (i) In general.
 - (ii) Amounts paid or accrued in cash and other consideration.
 - (iii) Transactions providing for net payments.

- (iv) Amounts paid or accrued with respect to mark-to-market position.
- (v) Coordination among categories of base erosion payments.
- (vi) Certain domestic passthrough entities.
 - (A) In general.
 - (B) Amount of base erosion payment.
 - (C) Specified domestic passthrough.
 - (D) Specified foreign related party.
- (vii) Transfers of property to related taxpayers.
 - (viii) Reductions to determine gross income.
 - (ix) Losses recognized on the sale or transfer of property.
- (3) Exceptions to base erosion payment.
 - (i) Certain services cost method amounts.
 - (A) In general.
 - (B) Eligibility for the services cost method exception.
 - (C) Adequate books and records.
 - (D) Total services cost.
 - (ii) Qualified derivative payments.
 - (iii) Effectively connected income.
 - (A) In general.
 - (B) Application to certain treaty residents.
 - (C) Application to partnerships.
 - (iv) Exchange loss on a section 988 transaction.
 - (v) Amounts paid or accrued with respect to TLAC securities and foreign TLAC securities.
 - (A) In general.
 - (B) Limitation on exclusion for TLAC securities.
 - (C) Scaling ratio.
 - (D) Average domestic TLAC securities amount.
 - (E) Average TLAC long-term debt required amount.
 - (F) Limitation on exclusion for foreign TLAC securities.
 - (1) In general.
 - (2) Foreign TLAC long-term debt required amount.
 - (3) No specified minimum provided by local law.
 - (4) Foreign TLAC security.
 - (vi) Amounts paid or accrued in taxable years beginning before January 1, 2018.
 - (vii) Business interest carried forward from taxable years beginning before January 1, 2018.

(viii) Specified nonrecognition transactions.

(A) In general.

(B) Other property transferred to a foreign related party in a specified nonrecognition transaction.

(C) Other property received from a foreign related party in certain specified nonrecognition transactions.

(D) Definition of other property

(E) Allocation of other property.

(ix) Reinsurance losses incurred and claims payments.

(A) In general.

(B) Regulated foreign insurance company.

(4) Rules for determining the amount of certain base erosion payments.

(i) Interest expense allocable to a foreign corporation's effectively connected income.

(A) Methods described in § 1.882-5.

(B) U.S.-booked liabilities determination.

(C) U.S.-booked liabilities in excess of U.S.-connected liabilities.

(D) Election to use financial statements.

(E) Coordination with certain tax treaties.

(1) In general.

(2) Hypothetical § 1.882-5 interest expense defined.

(3) Consistency requirement.

(F) Coordination with exception for foreign TLAC securities.

(ii) Other deductions allowed with respect to effectively connected income.

(iii) Depreciable property.

(iv) Coordination with ECI exception.

(v) Coordination with certain tax treaties.

(A) Allocable expenses.

(B) Internal dealings under certain income tax treaties.

(vi) Business interest expense arising in taxable years beginning after December 31, 2017.

(c) Base erosion tax benefit.

(1) In general.

(2) Exception to base erosion tax benefit.

(i) In general.

(ii) Branch-level interest tax.

(3) Effect of treaty on base erosion tax benefit.

(4) Application of section 163(j) to base erosion payments.

(i) Classification of payments or accruals of business interest expense based on the payee.

(A) Classification of payments or accruals of business interest expense of a corporation.

(B) Classification of payments or accruals of business interest expense by a partnership.

(C) Classification of payments or accruals of business interest expense paid or accrued to a foreign related party that is subject to an exception.

(1) ECI exception.

(2) TLAC interest and interest subject to withholding tax.

(ii) Ordering rules for business interest expense that is limited under section 163(j)(1) to determine which classifications of business interest expense are deducted and which classifications of business interest expense are carried forward.

(A) In general.

(B) Ordering rules for treating business interest expense deduction and disallowed business interest expense carryforwards as foreign related business interest expense, domestic related business interest expense, and unrelated business interest expense. (1) General ordering rule for allocating business interest expense deduction between classifications.

(2) Ordering of business interest expense incurred by a corporation.

(3) Ordering of business interest expense incurred by a partnership and allocated to a corporate partner.

(5) Allowed deduction.

(6) Election to waive allowed deductions.

(i) In general.

(ii) Time and manner for election to waive deduction.

(A) In general.

(B) Information required to make the election to waive allowed deductions.

(iii) Effect of election to waive deduction.

(A) In general.

(1) Consistent treatment.

(2) No allocation and apportionment of waived deductions.

(3) Effect of waiver of deductions described in §§ 1.861-10 and 1.861-10T.

(4) Effect of the election to waive deductions on the stock basis of a consolidated group member.

(B) Effect of the election to waive deductions disregarded for certain purposes.

(C) Not a method of accounting.

(D) Effect of the election in determining section 481(a) adjustments.

(iv) Rules applicable to partners and partnerships.

(A) In general.

(B) For determining the adjusted basis of a partner's interest in a partnership.

(C) Rule for applying section 163(j).

(D) Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241.

(v) Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A).

(d) Examples.

(1) Example 1: Determining a base erosion payment.

(i) Facts.

(ii) Analysis.

(2) Example 2: Interest allocable under § 1.882-5.

(i) Facts.

(ii) Analysis.

(3) Example 3: Interaction with section 163(j).

(i) Facts.

(ii) Analysis.

(A) Classification of business interest.

(B) Ordering rules for disallowed business interest expense carryforward.

(4) Example 4: Interaction with section 163(j); carryforward.

(i) Facts.

(ii) Analysis.

(A) Classification of business interest.

(B) Ordering rules for disallowed business interest expense carryforward.

(5) Example 5: Interaction with section 163(j); carryforward.

(i) Facts.

(ii) Analysis.

(6) Example 6: Interaction with section 163(j); partnership.

(i) Facts.

(ii) Partnership level analysis.

(iii) Partner level allocations analysis.

(iv) Partner level allocations for determining base erosion tax benefits.

(v) Computation of modified taxable income.

(7) Example 7: Transfers of property to related taxpayers.

- (i) Facts.
- (ii) Analysis.
- (A) Year 1.
- (B) Year 2.

(8) Example 8: Effect of election to waive deduction on method of accounting.

- (i) Facts.
- (ii) Analysis.

(9) Example 9: Change of accounting method when taxpayer has waived a deduction.

- (i) Facts.
- (ii) Analysis.
- (A) Computation of the section 481(a) adjustment.
- (B) Computation of basis adjustments.

§ 1.59A-4 Modified taxable income.

- (a) Scope.
- (b) Computation of modified taxable income.
 - (1) In general.
 - (2) Modifications to taxable income.
 - (i) Base erosion tax benefits.
 - (ii) Certain net operating loss deductions.
 - (3) Rule for holders of a residual interest in a REMIC.
- (c) Examples.
 - (1) Example 1: Current year loss.
 - (i) Facts.
 - (ii) Analysis.
 - (2) Example 2: Net operating loss deduction.
 - (i) Facts.
 - (ii) Analysis.

§ 1.59A-5 Base erosion minimum tax amount.

- (a) Scope.
- (b) Base erosion minimum tax amount.
 - (1) In general.
 - (2) Calculation of base erosion minimum tax amount.
 - (3) Credits that do not reduce regular tax liability.
 - (i) Taxable years beginning on or before December 31, 2025.
 - (ii) Taxable years beginning after December 31, 2025.
 - (c) Base erosion and anti-abuse tax rate.

- (1) In general.
 - (i) Calendar year 2018.
 - (ii) Calendar years 2019 through 2025.
 - (iii) Calendar years after 2025.
- (2) Increased rate for banks and registered securities dealers.
 - (i) In general.
 - (ii) De minimis exception to increased rate for banks and registered securities dealers.
- (3) Application of section 15 to tax rates in section 59A.
 - (i) New tax.
 - (ii) Change in tax rate pursuant to section 59A(b)(1)(A).
 - (iii) Change in rate pursuant to section 59A(b)(2).

§ 1.59A-6 Qualified derivative payment.

- (a) Scope.
- (b) Qualified derivative payment.
 - (1) In general.
 - (2) Reporting requirements.
 - (i) In general.
 - (ii) Failure to satisfy the reporting requirement.
 - (iii) Reporting of aggregate amount of qualified derivative payments.
 - (iv) Transition period for qualified derivative payment reporting.
 - (3) Amount of any qualified derivative payment.
 - (i) In general.
 - (ii) Net qualified derivative payment that includes a payment that is a base erosion payment.
 - (c) Exceptions for payments otherwise treated as base erosion payments.
 - (d) Derivative defined.
 - (1) In general.
 - (2) Exceptions.
 - (i) Direct interest.
 - (ii) Insurance contracts.
 - (iii) Securities lending and sale-repurchase transactions.
 - (A) Multi-step transactions treated as financing.
 - (B) Special rule for payments associated with the cash collateral provided in a securities lending transaction or substantially similar transaction.
 - (C) Anti-abuse exception for certain transactions that are the economic equivalent of substantially unsecured cash borrowing.

- (3) American depository receipts.
- (e) Examples.
 - (1) Example 1: Notional principal contract as QDP.
 - (i) Facts.
 - (ii) Analysis.
 - (2) Example 2: Securities lending anti-abuse rule.
 - (i) Facts.
 - (ii) Analysis.

§ 1.59A-7 Application of base erosion and anti-abuse tax to partnerships.

- (a) Scope.
- (b) Application of section 59A to partnerships.
 - (c) Base erosion payment.
 - (1) Payments made by or to a partnership.
 - (2) Transfers of certain property.
 - (3) Transfers of a partnership interest.
 - (i) In general.
 - (ii) Transfers of a partnership interest by a partner.
 - (iii) Certain issuances of a partnership interest by a partnership.
 - (iv) Partnership interest transfers defined.
 - (4) Increased basis from a distribution.
 - (5) Operating rules applicable to base erosion payments.
 - (i) Single payment characterized as separate transactions.
 - (ii) Ordering rule with respect to transfers of a partnership interest.
 - (iii) Consideration for base erosion payment or property resulting in base erosion tax benefits.
 - (iv) Non-cash consideration.
 - (v) Allocations of income in lieu of deductions.
 - (d) Base erosion tax benefit for partners.
 - (1) In general.
 - (2) Exception for base erosion tax benefits of certain small partners.
 - (i) In general.
 - (ii) Attribution.
 - (e) Other rules for applying section 59A to partnerships.
 - (1) Partner's distributive share.
 - (2) Gross receipts.
 - (i) In general.
 - (ii) Foreign corporation.
 - (3) Registered securities dealers.

(4) Application of sections 163(j) and 59A(c)(3) to partners.

(5) Tiered partnerships.

(f) Foreign related party.

(g) Examples.

(1) Facts.

(2) Examples.

(i) Example 1: Contributions to a partnership on partnership formation.

(A) Facts.

(B) Analysis.

(ii) Example 2: Section 704(c) and remedial allocations.

(A) Facts.

(B) Analysis.

(iii) Example 3: Sale of a partnership interest without a section 754 election.

(A) Facts.

(B) Analysis.

(iv) Example 4: Sale of a partnership interest with section 754 election.

(A) Facts.

(B) Analysis.

(v) Example 5: Purchase of depreciable property from a partnership.

(A) Facts.

(B) Analysis.

(vi) Example 6: Sale of a partnership interest to a second partnership.

(A) Facts.

(B) Analysis.

(vii) Example 7: Distribution of cash by a partnership to a foreign related party.

(A) Facts.

(B) Analysis.

(viii) Example 8: Distribution of property by a partnership to a taxpayer.

(A) Facts.

(B) Analysis.

(ix) Example 9: Distribution of property by a partnership in liquidation of a foreign related party's interest.

(A) Facts.

(B) Analysis.

(x) Example 10: Section 704(c) and curative allocations.

(A) Facts.

(B) Analysis.

§ 1.59A-8 [Reserved].

§ 1.59A-9 Anti-abuse and recharacterization rules.

(a) Scope.

(b) Anti-abuse rules.

(1) Transactions involving unrelated persons, conduits, or intermediaries.

(2) Transactions to increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.

(3) Transactions to avoid the application of rules applicable to banks and registered securities dealers.

(4) Nonrecognition transactions.

(5) Transactions involving derivatives on a partnership interest.

(6) Allocations to eliminate or reduce a base erosion payment.

(c) Examples.

(1) Facts.

(2) Example 1: Substitution of payments that are not base erosion payments for payments that otherwise would be base erosion payments through a conduit or intermediary.

(i) Facts.

(ii) Analysis.

(3) Example 2: Alternative transaction to base erosion payment.

(i) Facts.

(ii) Analysis.

(4) Example 3: Alternative financing source.

(i) Facts.

(ii) Analysis.

(5) Example 4: Alternative financing source that is a conduit.

(i) Facts.

(ii) Analysis.

(6) Example 5: Intermediary acquisition.

(i) Facts.

(ii) Analysis.

(7) Example 6: Offsetting transactions to increase the amount of deductions tak-

en into account in the denominator of the base erosion percentage computation.

(i) Facts.

(ii) Analysis.

(8) Example 7: Ordinary course transactions that increase the amount of deductions taken into account in the denominator of the base erosion percentage computation.

(i) Facts.

(ii) Analysis.

(9) Example 8: Transactions to avoid the application of rules applicable to banks and registered securities dealers.

(i) Facts.

(ii) Analysis.

(10) Example 9: Transactions that do not avoid the application of rules applicable to banks and registered securities dealers.

(i) Facts.

(ii) Analysis.

(11) Example 10: Acquisition of depreciable property in a nonrecognition transaction.

(i) Facts.

(ii) Analysis.

(12) Example 11: Transactions between related parties with a principal purpose of increasing the adjusted basis of property.

(i) Facts.

(ii) Analysis.

§ 1.59A-10 Applicability date.

(a) General applicability date.

(b) Exception.

§ 1.59A-1 [Amended]

Par. 3. Section 1.59A-1 is amended by removing the language in the "Remove" column from wherever it appears and adding in its place the language in the "Add" column for each paragraph listed in the table, as set forth below.

Paragraph	Remove	Add
(b)(6)	§ 1.163(j)-1(b)(2)	§ 1.163(j)-1(b)(3)
(b)(8)	§ 1.163(j)-1(b)(9)	§ 1.163(j)-1(b)(11)

Par. 4. Section 1.59A-2 is amended by:
1. In paragraph (c)(1), adding a sentence to the end of the paragraph.

2. Adding paragraphs (c)(2)(ii), (c)(4) through (6), and (c)(9).

3. In paragraph (f)(1), revising the paragraph heading.

4. Adding paragraph (f)(2).

The additions and revisions read as follows:

§ 1.59A-2 Applicable taxpayer.

* * * * *

(c) * * *

(1) * * * For purposes of this paragraph (c)(1), each payment or accrual is treated as a separate transaction.

(2) * * *

(ii) *Change in the composition of an aggregate group.* A change in ownership of the taxpayer (for example, a sale of the taxpayer to a third party) does not cause the taxpayer to leave its own aggregate group. Instead, any members of the taxpayer's aggregate group before the change in ownership that are no longer members following the change in ownership are treated as having left the taxpayer's aggregate group, and any new members that become members of the taxpayer's aggregate group following the change in ownership are treated as having joined the taxpayer's aggregate group. A change in ownership of another member of the aggregate group of the taxpayer (for example, a sale of the member to a third party) may result in the member joining or leaving the aggregate group of the taxpayer. See paragraph (c)(4) of this section for the treatment of members joining or leaving the aggregate group of a taxpayer.

* * * * *

(4) *Periods before and after a corporation is a member of an aggregate group—*

(i) *In general.* Solely for purposes of this section, to determine the gross receipts and the base erosion percentage of the aggregate group of a taxpayer, the taxpayer takes into account only the portion of another corporation's taxable year during which the corporation is a member of the aggregate group of the taxpayer. The gross receipts, base erosion tax benefits, and deductions of a corporation that are properly included in the gross receipts and base erosion percentage of the aggregate group of a taxpayer are not reduced as a result of the member leaving the aggregate group of the taxpayer.

(ii) *Deemed taxable year-end.* Solely for purposes of this paragraph (c), if a corporation leaves or joins the aggregate group of a taxpayer, the corporation is treated as ceasing to be a member of the

aggregate group at the time of its taxable year-end, or becoming a member of the aggregate group immediately after the time of its taxable year-end, resulting from the transaction. For purposes of this paragraph (c), if a corporation joins or leaves an aggregate group in a transaction that does not result in the corporation having a taxable year-end, the corporation is treated as having a taxable year-end ("deemed taxable year-end") at the end of the day on which the transaction occurs.

(iii) *Items allocable to deemed taxable years before and after deemed taxable year-end.* Solely for purposes of this paragraph (c), a corporation that has a deemed taxable year-end determines gross receipts, base erosion tax benefits, and deductions attributable to the deemed taxable year ending upon, or beginning immediately after, the deemed taxable year-end by either treating the corporation's books as closing ("deemed closing of the books") at the deemed taxable year-end or, in the case of items other than extraordinary items, allocating those items on a pro-rata basis without a closing of the books. Extraordinary items are allocated to the deemed taxable year ending upon, or beginning immediately after, the deemed taxable year-end based on the day that they are taken into account. For purposes of applying this paragraph (c)(4) (iii), "extraordinary items" include the items enumerated in § 1.1502-76(b)(2) (ii)(C) as well as any other payment not made in the ordinary course of business that would be treated as a base erosion payment.

(5) *Short taxable year—*(i) *Short period of the taxpayer—*(A) *In general.* Solely for purposes of this section, if a taxpayer has a taxable year of fewer than 12 months (a short period), the gross receipts, base erosion tax benefits, and deductions of the taxpayer are annualized by multiplying the total amount for the short period by 365 and dividing the result by the number of days in the short period.

(B) *Determining the gross receipts and base erosion percentage of the aggregate group of a taxpayer for a short period.* When a taxpayer has a taxable year that is a short period and a member of the taxpayer's aggregate group does not have a taxable year that ends with or within the taxpayer's taxable year as a result of the taxpayer's short period, the taxpayer must use a reasonable approach to determine the gross receipts and base erosion percentage of its aggregate group for the short period. A reasonable approach should neither over-count nor under-count the gross receipts, base erosion tax benefits, and deductions of the aggregate group of the taxpayer. A reasonable approach does not include an approach that does not take into account the gross receipts, base erosion tax benefits, or deductions of the member. The taxpayer must consistently apply the reasonable approach. Examples of a reasonable approach may include an approach that takes into account 12 months of gross receipts, base erosion tax benefits, and deductions of the member by reference to—

(1) The 12-month period ending on the last day of the short period;

(2) The member's taxable year that ends nearest to the last day of the short period or that begins nearest to the first day of the short period; or

(3) An average of the two taxable years of the member ending before and after the short period.

(ii) *Short period of a member of the taxpayer's aggregate group—*(A) *Multiple taxable years of a member of the taxpayer's aggregate group comprised of more than 12 months.* If a member of a taxpayer's aggregate group has more than one taxable year ending with or within the taxpayer's taxable year, and the member's taxable years ending with or within the taxpayer's taxable year are comprised of more than 12 months in total, then the aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group. The aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized by multiplying the total amount for the member's taxable years by 365 and dividing the

result by the total number of days in the multiple taxable years.

(B) *Short period or periods of a member of the taxpayer's aggregate group comprised of fewer than 12 months from change in taxable year.* If, as a result of a member of a taxpayer's aggregate group changing its taxable year-end (other than as a result of the application of § 1.1502-76(a)), the member's taxable year or years ending with or within the taxpayer's taxable year are comprised of fewer than 12 months in total, then the aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized for purposes of determining the gross receipts and base erosion percentage of the taxpayer's aggregate group. The aggregate group member's gross receipts, base erosion tax benefits, and deductions are annualized by multiplying the total amount for the member's taxable year or years by 365 and dividing the result by the total number of days in the taxable year or years.

(iii) *Anti-abuse rule.* If a taxpayer or a member of a taxpayer's aggregate group enters into a transaction (or series of transactions), plan, or arrangement with another corporation that is a member of the aggregate group or a foreign related party that has a principal purpose of changing the period taken into account under the gross receipts test or the base erosion percentage test to avoid applicable taxpayer status under paragraph (b) of this section, then the gross receipts test or base erosion percentage test, respectively, applies as if that transaction (or series of transactions), plan, or arrangement had not occurred.

(6) *Treatment of predecessors—(i) In general.* Solely for purposes of this section, in determining gross receipts under paragraph (d) of this section, any reference to a taxpayer includes a reference to any predecessor of the taxpayer. For this purpose, a predecessor is the distributor or transferor corporation in a transaction described in section 381(a) in which the taxpayer is the acquiring corporation. For purposes of determining the gross receipts of a predecessor that are taken into account by a taxpayer, the operating rules set forth in this paragraph (c) and in paragraph (d) of this section are applied to the same extent they were applied to the predecessor.

(ii) *No duplication.* If the taxpayer or any member of its aggregate group is

also a predecessor of the taxpayer or any member of its aggregate group, the gross receipts of each member are taken into account only once.

* * * * *

(9) *Consolidated groups.* For the treatment of consolidated groups for purposes of determining gross receipts and base erosion tax benefits, see § 1.1502-59A(b).

* * * * *

(f) * * *

(1) *Example 1: Mark-to market**

* *

(2) *Example 2: Member leaving an aggregate group—(i) Facts.* Parent Corporation wholly owns Corporation 1 and Corporation 2. Each corporation is a domestic corporation and a calendar-year taxpayer that does not file a consolidated return. The aggregate group of Corporation 1 includes Parent Corporation and Corporation 2. At noon on June 30, Year 1, Parent Corporation sells the stock of Corporation 2 to Corporation 3, an unrelated domestic corporation, in exchange for cash consideration. Before the acquisition, Corporation 3 was not a member of an aggregate group. Corporation 2 and Corporation 3 do not file a consolidated return.

(ii) *Analysis.* (A) For purposes of section 59A, to determine the gross receipts and base erosion percentage of the aggregate group of Corporation 1 for calendar Year 1, Corporation 2 is treated as having a taxable year-end at the end of the day on June 30, Year 1, as a result of the sale. Corporation 2 leaves the aggregate group of Corporation 1 and Parent Corporation at the end of the day on June 30, Year 1. The aggregate group of Corporation 1 takes into account only the gross receipts, base erosion tax benefits, and deductions of Corporation 2 allocable to the period from January 1 to the end of the day on June 30, Year 1, in accordance with paragraph (c)(4)(ii) and (iii) of this section. The same results apply to the aggregate group of Parent Corporation for calendar Year 1. See paragraph (d)(1) and (2) of this section for the periods taken into account in determining whether the taxpayer or its aggregate group satisfies the gross receipts test.

(B) For purposes of section 59A, to determine the gross receipts and base erosion percentage of the aggregate group of Corporation 2 for calendar Year 1, each of

Parent Corporation, Corporation 1, and Corporation 3 are treated as having a taxable year-end at the end of the day on June 30, Year 1. Because Corporation 2 does not have a short taxable year, paragraph (c)(5)(i) of this section does not apply. The aggregate group of Corporation 2 takes into account the gross receipts, base erosion tax benefits, and deductions of Parent Corporation and Corporation 1 allocable to the period from January 1 to the end of the day on June 30, Year 1, and the gross receipts, base erosion tax benefits, and deductions of Corporation 3 allocable to the period from July 1 to December 31, Year 1 in accordance with paragraph (c)(4)(ii) and (iii) of this section. See paragraph (d)(1) and (2) of this section for the periods taken into account in determining whether the taxpayer or its aggregate group satisfies the gross receipts test.

Par. 5. Section 1.59A-3 is amended by adding paragraphs (b)(3)(iii)(C), (c)(5) and (6), and (d)(8) and (9) to read as follows:

§ 1.59A-3 Base erosion payments and base erosion tax benefits.

* * * * *

(b) * * *

(3) * * *

(iii) * * *

(C) *Application to partnerships.* To the extent that paragraph (b)(3)(iii)(A) or (B) of this section would apply to a payment or accrual made directly by a taxpayer to a foreign related party, paragraph (b)(3)(iii)(A) or (B) of this section apply to an amount treated as paid or accrued by a taxpayer to a foreign related party under § 1.59A-7(b) or (c) (generally applying aggregate principles to treat partnership transactions as partner-level transactions for purposes of section 59A). The certification requirement in paragraph (b)(3)(iii)(A) of this section is met if the taxpayer receives a written statement from the foreign related party that is comparable to the certification provided in paragraph (b)(3)(iii)(A) of this section but based on the deemed transaction under § 1.59A-7(b) or (c) and the extent to which paragraph (b)(3)(iii)(A) or (B) of this section would have applied to that deemed transaction. The taxpayer may rely on the written statement unless it has reason to know or

actual knowledge that the statement is incorrect.

* * * * *

(c) * * *

(5) *Allowed deduction.* Solely for purposes of paragraph (c)(1) of this section, all deductions (and any premium or other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A)) that could be properly claimed by a taxpayer for the taxable year (determined after giving effect to the taxpayer's permissible method of accounting and to any election, such as the election under section 173 to capitalize circulation expenditures or the election under section 168(g)(7) to use the alternative depreciation system of depreciation) are treated as allowed deductions under chapter 1 of subtitle A of the Internal Revenue Code.

(6) *Election to waive allowed deductions—(i) In general.* If a taxpayer elects to waive certain deductions, in whole or in part, pursuant to this paragraph (c)(6)(i), the amount of allowed deductions as described in paragraph (c)(5) of this section is reduced by the amounts that are properly waived. In order to make the election or increase the amount of the deduction waived, the taxpayer must determine that it could satisfy the requirements of § 1.59A-2(b) absent the election to waive certain deductions. For rules applicable to partners and partnerships, see paragraph (c)(6)(iv) of this section. For rules addressing waiver of premium or other consideration paid or accrued by a taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A), see paragraph (c)(6)(v) of this section.

(ii) *Time and manner for election to waive deduction—(A) In general.* A taxpayer may make the election described in paragraph (c)(6)(i) of this section on its original filed Federal income tax return. In addition, a taxpayer may elect to waive deductions or increase the amount of deductions waived pursuant to the election described in paragraph (c)(6)(i) of this section on an amended Federal income tax return filed within the later of three years from the date the original return was filed, taking into account section 6501(b)(1), for the taxable year for which the election is

made or the period described in section 6501(c)(4), or during the course of an examination of the taxpayer's income tax return for the relevant taxable year pursuant to procedures prescribed by the Commissioner. However, a taxpayer may not decrease the amount of deductions waived by the election, or otherwise revoke the election that is described in paragraph (c)(6)(i) of this section on any amended Federal income tax return or during the course of an examination. To make the election, a taxpayer must complete the appropriate part of Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts* (or successor), including the information described in paragraph (c)(6)(ii)(B) of this section and any other information required by the form or instructions. A taxpayer makes the election described in paragraph (c)(6)(i) of this section on an annual basis, and the taxpayer does not need the consent of the Commissioner if the taxpayer chooses not to make the election for a subsequent taxable year. The election described in paragraph (c)(6)(i) of this section may not be made in any other manner than as described in this paragraph (c)(6)(ii) (for example, by filing an application for a change in accounting method).

(B) *Information required to make the election to waive allowed deductions.* To make this election, a taxpayer must maintain contemporaneous documentation and provide information related to each deduction waived as required by applicable forms and instructions issued by the Commissioner, including—

(1) A description of the item or property to which the deduction relates, including sufficient information to identify that item or property on the taxpayer's books and records;

(2) The date on which, or period in which, the waived deduction was paid or accrued;

(3) The provision of the Internal Revenue Code (and regulations, as applicable) that allows the deduction for the item or property to which the election relates;

(4) The amount of the deduction that is claimed for the taxable year with respect to the item or property;

(5) The amount of the deduction being waived for the taxable year with respect to the item or property;

(6) A description of where the deduction is reflected (or would have been reflected) on the Federal income tax return (such as a line number); and

(7) The name, Taxpayer Identification Number (or, if the foreign person does not have a Taxpayer Identification Number, the foreign equivalent), and country of organization of the foreign related party that is or will be the recipient of the payment that generates the deduction.

(iii) *Effect of election to waive deduction—(A) In general—(1) Consistent treatment.* Except as otherwise provided in this paragraph (c)(6)(iii), any deduction waived under paragraph (c)(6)(i) of this section is treated as having been waived for all purposes of the Internal Revenue Code and regulations.

(2) *No allocation and apportionment of waived deductions.* The waiver of deductions described in paragraph (c)(6)(i) of this section is treated as occurring before the allocation and apportionment of deductions under §§ 1.861-8 through 1.861-14T and 1.861-17 (such as for purposes of section 904).

(3) *Effect of waiver of deductions described in §§ 1.861-10 and 1.861-10T.* To the extent that any waived deduction is interest expense that would have been directly allocated under the rules of § 1.861-10 or 1.861-10T and would have resulted in the reduction of value of any assets for purposes of allocating other interest expense under §§ 1.861-9 and 1.861-9T, the value of the assets is reduced to the same extent as if the taxpayer had not elected to waive the deduction.

(4) *Effect of the election to waive deductions on the stock basis of a consolidated group member.* For purposes of § 1.1502-32, any deduction waived under paragraph (c)(6)(i) of this section is a non-capital, nondeductible expense under § 1.1502-32(b)(2)(iii).

(B) *Effect of the election to waive deductions disregarded for certain purposes.* If a taxpayer makes the election to waive a deduction, in whole or in part, under paragraph (c)(6)(i) of this section, the election is disregarded for determining—

(1) The taxpayer's overall method of accounting, or the taxpayer's method of accounting for any item, under section 446;

(2) Whether a change in the taxpayer's overall plan of accounting or the tax-

payer's treatment of a material item is a change in method of accounting under section 446(e) and § 1.446-1(e);

(3) The amount allowable under subtitle A of the Internal Revenue Code for depreciation or amortization for purposes of section 167(c) and section 1016(a)(2) or section 1016(a)(3) and any other adjustment to basis under section 1016(a);

(4) For purposes of applying the exclusive apportionment rule in § 1.861-17(b), the geographic source where the research and experimental activities which account for more than fifty percent of the amount of the deduction for research and experimentation was performed;

(5) The application of section 482;

(6) The amount of the taxpayer's earnings and profits; and

(7) Any other item as necessary to prevent a taxpayer from receiving the benefit of a waived deduction.

(C) *Not a method of accounting.* The election described in paragraph (c)(6)(i) of this section is not a method of accounting under section 446.

(D) *Effect of the election in determining section 481(a) adjustments.* A taxpayer making the election described in paragraph (c)(6)(i) of this section agrees that if the method of accounting for a waived deduction is changed, the amount of adjustment taken into account under section 481(a)(2) is determined without regard to the election described in paragraph (c)(6)(i) of this section. As a result, a waived deduction has no effect on the amount of a section 481(a) adjustment compared to what the adjustment would have been if the deduction had not been waived. See paragraph (d)(9) of this section (*Example 9*).

(iv) *Rules applicable to partners and partnerships—(A) In general.* Except as provided in paragraph (c)(6)(iv)(D) of this section, deductions allocated to a corporate partner by a partnership may only be waived by the partner and not by the partnership, and then only to the extent the partner otherwise qualifies for the waiver under paragraph (c)(6) of this section. For purposes of complying with the documentation requirements in paragraph (c)(6)(ii)(B) of this section, the partner is not required to report the information in paragraphs (c)(6)(ii)(B)(2) and (3) of this section, and in lieu of reporting the information in paragraphs (c)(6)(ii)(B)(1) of this section, the partner

is required to report the partnership from which the item is allocated.

(B) *Rule for determining the adjusted basis of a partner's interest in a partnership.* If a partner elects to waive a deduction or increases the amount of deduction waived with respect to deductions allocated to it by a partnership, the partner treats the waived amount as a nondeductible expenditure under section 705(a)(2)(B).

(C) *Rule for applying section 163(j).* If a partner waives a deduction pursuant to paragraph (c)(6)(iv)(A) of this section that was taken into account by the partnership in determining the partnership's adjusted taxable income for purposes of section 163(j), then the increase in the partner's income resulting from the waiver is treated by the partner (but not the partnership) as a partner basis item (as defined in § 1.163(j)-6(b)(2)) for purposes of section 163(j).

(D) *Limited application of election to waive deductions with respect to adjustments made pursuant to audit procedures under sections 6221 through 6241.* Except as provided in this paragraph (c)(6)(iv)(D), a partner is not permitted to waive any adjustment by the Secretary to any partnership-related items that is made pursuant to subchapter C of chapter 63. A partner in a partnership subject to subchapter C of chapter 63 may only make an election to waive any increase in a deduction due to an adjustment made under subchapter C of chapter 63 that the partner takes into account under section 6225(c)(2)(A), 6226, or 6227 in a manner consistent with paragraph (c)(6) of this section. If the partner makes an election under paragraph (c)(6)(i) of this section, the partner will compute its additional reporting year tax (as described in § 301.6226-3 of this chapter) or amount due under § 301.6225-2(d)(2)(ii)(A) of this chapter taking into account the rules in paragraph (c)(6) of this section with respect to the increase in the deduction that is waived.

(v) *Rule applicable to premium and other consideration paid or accrued by the taxpayer for any reinsurance payments that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A).* For purposes of paragraph (c)(6)(i) of this section, a taxpayer may elect to waive (or increase the amount waived of) any premium or other consideration paid or accrued by the taxpayer for any reinsurance payments

that are taken into account under section 803(a)(1)(B) or 832(b)(4)(A) that would be a base erosion tax benefit within the meaning of section 59A(c)(2)(A)(iii), in accordance with the rules and principles of this paragraph (c)(6).

(d) * * *

(8) *Example 8: Effect of election to waive deduction on method of accounting—(i) Facts.* DC, a domestic corporation, purchased and placed in service a depreciable asset (Asset A) from a foreign related party on the first day of its taxable year 1 for \$100x. DC elects to use the alternative depreciation system under section 168(g) to depreciate all properties placed in service during taxable year 1. Asset A is not eligible for the additional first year depreciation deduction. Beginning in taxable year 1, DC depreciates Asset A under the alternative depreciation system using the straight-line depreciation method, a 5-year recovery period, and the half-year convention. This depreciation method, recovery period, and convention are permissible for Asset A under section 168(g). On its timely filed original Federal income tax return for taxable year 1, DC does not elect to waive any deductions and DC claims a depreciation deduction of \$10x for Asset A. On its timely filed original Federal income tax return for taxable year 2, DC does not elect to waive any deductions and DC claims a depreciation deduction of \$20x for Asset A. During taxable year 3, DC files an amended return for taxable year 1 to elect to waive the depreciation deduction for Asset A and reports in accordance with paragraph (c)(6)(ii) of this section with its amended return for taxable year 1 that the amount of the waived depreciation deduction for Asset A is \$10x and the amount of the claimed depreciation deduction is \$0x.

(ii) *Analysis.* Pursuant to paragraph (c)(6)(iii)(B)(1) of this section, DC's election to waive the depreciation deduction for Asset A for taxable year 1 is disregarded for determining DC's method of accounting for Asset A. Accordingly, after DC's election to waive the depreciation deduction for Asset A for taxable year 1, DC's method of accounting for depreciation for Asset A continues to be the straight-line depreciation method, a 5-year recovery period, and the half-year convention. Pursuant to paragraph (c)(6)(iii)(C) of this

section, the election made by DC in taxable year 3 on its amended return for taxable year 1 is not a method of accounting.

(9) *Example 9: Change of accounting method when taxpayer has waived a deduction*—(i) *Facts.* DC, a domestic corporation, purchased and placed in service a depreciable asset (Asset B) from a foreign related party on the first day of its taxable year 1 for \$100x. DC elects to use the alternative depreciation system under section 168(g) to depreciate all properties placed in service during taxable year 1. Asset B is not eligible for the additional first year depreciation deduction. Beginning in taxable year 1, DC depreciates Asset B under the alternative depreciation system using the straight-line depreciation method, a 10-year recovery period, and the half-year convention. Under this method of accounting, the depreciation deductions for Asset B are \$5x for taxable year 1 and \$10x for taxable year 2. However, for taxable years 1 and 2, DC elects to waive \$3x and \$6x, respectively, of the depreciation deductions for Asset B and reports the information required under paragraph (c)(6)(ii) of this section with its returns. In taxable year 3, DC realizes that the correct recovery period for Asset B is 5 years. If DC had used the correct recovery period for Asset B, the depreciation deductions for Asset B would have been \$10x for taxable year 1 and \$20x for taxable year 2. DC timely files a Form 3115 to change its method of accounting for Asset B from a 10-year recovery period to a 5-year recovery period, beginning with taxable year 3. DC was not under examination as of the date on which it timely filed this Form 3115.

(ii) *Analysis*—(A) *Computation of the section 481(a) adjustment.* In determining the net negative section 481(a) adjustment for this method change, DC compares the depreciation deductions under its present method of accounting to the depreciation deductions under its proposed method of accounting. Pursuant to paragraph (c)(6)(iii)(D) of this section, DC agreed that, by making the election to waive depreciation

deductions for Asset B, DC will not take into account the fact that depreciation deductions for Asset B were waived under paragraph (c)(6)(i) of this section. Accordingly, DC's net negative section 481(a) adjustment for this method change is \$15x, which is calculated by determining the difference between the depreciation deductions for Asset B for taxable years 1 and 2 under DC's present method of accounting (\$15x) and the depreciation deductions that would have been allowable for Asset B for taxable years 1 and 2 under DC's proposed method of accounting (\$30x).

(B) *Computation of basis adjustments.* Pursuant to paragraph (c)(6)(iii)(B)(3) of this section, DC's elections to waive the depreciation deductions for Asset B for taxable years 1 and 2 are disregarded for determining the amount allowable for depreciation for purposes of section 1016(a)(2). The amount allowable for depreciation of Asset B is determined based on the proper method of computing depreciation for Asset B. Accordingly, Asset B's adjusted basis at the end of taxable year 1 is \$90x (\$100x - \$10x) and at the end of taxable year 2 is \$70x (\$90x - \$20x).

Par. 6. Section 1.59A-7 is amended by:

1. Adding paragraph (c)(5)(v).
2. In paragraph (e)(2)(ii), removing the language “§ 1.59A-2(d)(2)” and adding the language “§ 1.59A-2(d)(3)” in its place.
3. Adding paragraph (g)(2)(x).

The additions read as follows:

§ 1.59A-7 Application of base erosion and anti-abuse tax to partnerships.

* * * * *

(c) * * *

(5) * * *

(v) *Allocations of income in lieu of deductions.* If a partnership adopts the curative method of making section 704(c) allocations under § 1.704-3(c), an allocation of income to the partner to whom any built-in gain or built-in loss would be allocable under section 704(c) (the 704(c)

partner), in an amount necessary to offset the effect of the ceiling rule (as defined in § 1.704-3(b)(1)), in lieu of a deduction allocation to a partner other than the 704(c) partner (a non-704(c) partner), is treated as a deduction to the non-704(c) partner for purposes of section 59A in an amount equal to the income allocation. See paragraph (g)(2)(x) of this section (*Example 10*) for an example illustrating the application of this paragraph (c)(5)(v).

* * * * *

(g) * * *

(2) * * *

(x) *Example 10: Section 704(c) and curative allocations*—(A) *Facts.* The facts are the same as in paragraph (d)(2)(ii)(A) of this section (the facts in *Example 2*), except that DC's property is not depreciable, PRS uses the traditional method with curative allocations under § 1.704-3(c), and the curative allocations are to be made from operating income. Also assume that the partnership has \$20x of gross operating income in each year and a curative allocation of the operating income satisfies the “substantially the same effect” requirement of § 1.704-3(c)(3)(iii)(A).

(B) *Analysis.* The analysis and results are the same as in paragraph (d)(2)(i)(B) of this section (the analysis in *Example 1*), except that actual depreciation is \$8x (\$40x/5) per year and the ceiling rule shortfall under § 1.704-3(b)(1) of \$2x per year is corrected with a curative allocation of income from DC to FC of \$2x per year. Solely for U.S. federal income tax purposes, each year FC is allocated \$12x of total operating income and DC is allocated \$8x of operating income. Both the actual depreciation deduction to DC and the curative allocation of income from DC are base erosion tax benefits to DC under paragraphs (c)(5)(v) and (d)(1) of this section.

Par. 7. Section 1.59A-9 is amended by:

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

Paragraph	Remove	Add
(b)(1)	plan or	plan, or
(b)(2)	plan or	plan, or
(b)(3)	plan or	plan, or
(c)(3)(ii)	plan or	plan, or

2. Revising paragraph (b)(4).
3. Adding paragraphs (b)(5) and (6).
4. Revising paragraphs (c)(11)(ii) and (c)(12).

The revisions and addition read as follows:

§ 1.59A-9 Anti-abuse and recharacterization rules.

* * * * *

(b) * * *

(4) *Nonrecognition transactions.* If a transaction (or series of transactions), plan, or arrangement (the first transaction) increases the adjusted basis of property that the taxpayer acquires in a transaction (the second transaction) that qualifies for the specified nonrecognition transaction exception in § 1.59A-3(b)(3)(viii)(A) (or would qualify, but for this paragraph (b)(4)), and a principal purpose of the first transaction was to increase the taxpayer's depreciation or amortization deductions without increasing the taxpayer's base erosion tax benefits, then § 1.59A-3(b)(3)(viii)(A) does not apply to the property acquired in the second transaction to the extent of the increase in adjusted basis. For purposes of this paragraph (b)(4), if a transaction (or series of transactions), plan, or arrangement between related parties increases the adjusted basis of property within the six-month period before the taxpayer acquires the property, the transaction (or series of transactions), plan, or arrangement is deemed to have such a principal purpose.

(5) *Transactions involving derivatives on a partnership interest.* If a taxpayer acquires a derivative on a partnership interest (or partnership assets) as part of a transaction (or series of transactions), plan, or arrangement that has as a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment) and the partnership interest (or partnership assets) would have resulted in a base erosion payment had the taxpayer acquired that interest (or partnership asset) directly, then the taxpayer is treated as having a direct interest instead of a derivative interest for purposes of applying section 59A. This paragraph (b)(5), however, does not apply to a derivative, as defined in section 59A(h)(4)(A)(v), on a partnership asset to the extent the

payment pursuant to the derivative qualifies for the exception for qualified derivative payments in § 1.59A-3(b)(3)(ii) and § 1.59A-6. A derivative interest in a partnership includes any contract (including any financial instrument) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined in whole or in part by reference to the partnership, including the amount of partnership distributions, the value of partnership assets, or the results of partnership operations.

(6) *Allocations to eliminate or reduce a base erosion payment.* If a partnership receives (or accrues) an amount from a person not acting in a partner capacity (including a person who is not a partner) and allocates the income or loss with respect to that amount to its partners with a principal purpose of avoiding a base erosion payment (or reducing the amount of a base erosion payment), then the taxpayer transacting (directly or indirectly) with the partnership will determine its base erosion payment as if the allocations had not been made and the items of income or loss had been allocated proportionately. The preceding sentence applies only when the allocations, in combination with any related allocations, do not change the economic arrangement of the partners to the partnership.

(c) * * *

(11) * * *

(ii) *Analysis.* Paragraph (b)(4) of this section does not apply to DC's acquisition of Property 1 because the purchase of Property 1 from U (first transaction) did not have a principal purpose of increasing DC's adjusted basis of Property 1 without increasing DC's base erosion tax benefits. The transaction is economically equivalent to an alternative transaction under which FP contributed \$100x to DC and then DC purchased Property 1 from U. Further, the second sentence of paragraph (b)(4) of this section (providing that certain transactions are deemed to have a principal purpose of increasing the adjusted basis of property acquired in a second transaction) does not apply because FP purchased Property 1 from an unrelated party.

(12) *Example 11: Transactions between related parties with a principal purpose of increasing the adjusted basis*

of property—(i) *Facts.* The facts are the same as paragraph (c)(11)(i) of this section (the facts in *Example 10*), except that U is related to FP and DC.

(ii) *Analysis.* Paragraph (b)(4) of this section applies to DC's acquisition of Property 1 because the transaction that increased the adjusted basis of Property 1 (the purchase of Property 1 from U) was between related parties, and within six months DC acquired Property 1 from FP in a specified nonrecognition transaction. Accordingly, the purchase of property from U (first transaction) is deemed to have a principal purpose of increasing the adjusted basis of Property 1 that DC acquires in the second transaction – the contribution (a transaction that qualifies as a specified nonrecognition transaction in part and would wholly qualify but for the application of paragraph (b)(4) of this section). Accordingly, the exception in § 1.59A-3(b)(3)(viii)(A) for specified nonrecognition transactions does not apply to the contribution of Property 1 to DC to the extent of the increased adjusted basis from the first transaction (\$50x), and DC's depreciation deductions with respect to Property 1 will be base erosion tax benefits to the extent of the \$50x increase in adjusted basis in Property 1.

Par. 8. Section 1.59A-10 is revised to read as follows:

§ 1.59A-10 Applicability date.

(a) *General applicability date.* Sections 1.59A-1 through 1.59A-9, other than the provisions described in the first sentence of paragraph (b) of this section, apply to taxable years ending on or after December 17, 2018. However, taxpayers may apply these regulations in their entirety for taxable years beginning after December 31, 2017, and ending before December 17, 2018. In lieu of applying the regulations referred to in the first sentence of this paragraph, taxpayers may apply the provisions matching §§ 1.59A-1 through 1.59A-9 from the Internal Revenue Bulletin (IRB) 2019-02 (https://www.irs.gov/irb/2019-02_IRB) in their entirety for all taxable years beginning after December 31, 2017 and ending on or before December 6, 2019.

(b) *Exception.* Sections 1.59A-2(c)(2)(ii) and (c)(4) through (6), 1.59A-3(b)(3)(iii)

(C), 1.59A-3(c)(5) and (6), and 1.59A-9(b)(4) apply to taxable years *beginning* on or after October 9, 2020, and §§ 1.59A-7(c)(5)(v) and 1.59A-9(b)(5) and (6) apply to taxable years ending on or after December 2, 2019. Taxpayers may apply those regulations in their entirety for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once

applied, taxpayers must continue to apply them in their entirety for all subsequent taxable years. Alternatively, taxpayers may apply only § 1.59A-3(c)(5) and (6) for taxable years beginning after December 31, 2017, and before their applicability date, provided that, once applied, taxpayers must continue to apply § 1.59A-3(c)(5) and (6) in their entirety for all subsequent taxable years.

§ 1.1502-59A [Amended]

Par. 9. Section 1.1502-59A is amended by removing the language in the “Remove” column from wherever it appears and adding in its place the language in the “Add” column for each paragraph listed in the table, as set forth below.

Paragraph	Remove	Add
(f)(6)	§ 1.163(j)-1(b)(2)	§ 1.163(j)-1(b)(3)
(f)(14)	§ 1.163(j)-1(b)(9)	§ 1.163(j)-1(b)(11)
(f)(21)	§ 1.163(j)-1(b)(31)	§ 1.163(j)-1(b)(36)

Par. 10. Section 1.6031(a)-1 is amended by:

1. Adding paragraph (b)(7).
2. Designating paragraph (f) as paragraph (f)(1).
3. Adding paragraph (f)(2).

The additions read as follows:

§ 1.6031(a)-1 Return of partnership income.

* * * * *

(b) * * *

(7) *Filing obligation for certain partners of certain foreign partnerships with respect to base erosion payments.* If a foreign partnership is not required to file a partnership return and the foreign partnership has made a payment or accrual that is

treated as a base erosion payment of a partner as provided in § 1.59A-7(c), a partner in the foreign partnership who is a person required to file a Form 8991 (or successor) must include the information necessary to report those base erosion payments and base erosion tax benefits on Form 8991 (or successor) in accordance with the related instructions. A partner with a Form 8991 (or successor) filing requirement who is a partner in a foreign partnership that is not required to file a partnership return must obtain the necessary information to report any base erosion payments on Form 8991 (or successor) from the foreign partnership or from any other reliable records of these payments. This paragraph does not apply to any partner described in § 1.59A-7(d)(2).

* * * * *

(f) * * *

(2) *Applicability date.* Paragraph (b)(7) of this section applies to taxable years ending on or after October 9, 2020.

Sunita Lough,
*Deputy Commissioner for Services
and Enforcement.*

Approved: August 24, 2020

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

(Filed by the Office of the Federal Register on October 08, 2020, 8:45 a.m., and published in the issue of the Federal Register for October 09, 2020, 85 F.R. 64346)

Part III

Section 3401, 3402. —Final Regulations on Income Tax Withholding from Wages

26 CFR 31: Employment Taxes and Collection of Income.

T.D. 9924

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

Income Tax Withholding from Wages

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document sets forth final regulations that provide guidance for employers concerning income tax withholding from employees' wages. These final regulations concern the amount of Federal income tax employers withhold from employees' wages, implement changes in the Internal Revenue Code made by the Tax Cuts and Jobs Act, and reflect the redesigned withholding allowance certificate (Form W-4) and related IRS publications. These final regulations affect employers that pay wages subject to Federal income tax withholding and employees who receive wages subject to Federal income tax withholding.

DATES: *Effective Date:* These final regulations are effective on October 6, 2020.

Applicability Dates: For dates of applicability see §§31.3402(a)-1(h), 31.3402(b)-1(b), 31.3402(c)-1(f), 31.3402(f)(1)-1(c),

31.3402(f)(2)-1(h), 31.3402(f)(3)-1(d), 31.3402(f)(4)-1(e), 31.3402(f)(5)-1(d), 31.3402(f)(6)-1(c), 31.3402(g)-1(d), 31.3402(h)(4)-1(c), 31.3402(i)-1(b), 31.3402(l)-1(e), 31.3402(m)-1(f), and 31.3402(n)-1(f).

FOR FURTHER INFORMATION CONTACT: Concerning these final regulations, Mikhail Zhidkov of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes), (202) 317-4774 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Section 3402(a)(1) provides that, except as otherwise provided in section 3402, every employer making a payment of wages shall deduct and withhold from such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary of the Treasury. Section 3402(a)(1) further provides that any tables or procedures prescribed under section 3402(a)(1) shall be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of chapter 1 (imposition of individual income tax). Section 3402 sets forth certain methods of withholding but also gives the Secretary broad regulatory authority in providing for tables or computational procedures for income tax withholding.

Generally, employers apply the withholding tables or computational procedures based on the entries on the Form W-4 the employee furnishes the employer. An employee who receives wages subject to withholding under section 3402 is required to furnish his or her employer a Form W-4 on commencement of employment or, generally, within 10 days after the employee experiences a “change of sta-

tus” that reduces the “withholding allowance” to which the employee is entitled. *See* section 3402(f)(2).

An employee completes Form W-4 based on the employee's personal tax situation by applying the factors listed in section 3402(f)(1). Section 3402(f)(1) describes the combination of these factors as the employee's “withholding allowance.” Once an employee completes a valid Form W-4, the employee must furnish the Form W-4 to the employer. The employer puts the Form W-4 into effect in accordance with the timing rules in section 3402(f)(3). Once in effect, the employer generally applies the entries on an employee's Form W-4 (the withholding allowance) to compute the amount of income tax to withhold from the employee's regular wages under either the percentage method of withholding or the wage bracket method of withholding. *See* section 3402(b) and (c).¹

In certain cases, the IRS may issue an employer a lock-in letter that notifies the employer in writing that an employee is not entitled to claim exemption from withholding or is not entitled to the withholding allowance claimed on the employee's Form W-4 and prescribes the withholding allowance the employer must use to figure withholding. If the employer employs the employee at the time the employer receives the lock-in letter, the employer must furnish the employee notice of the lock-in letter within 10 days of receipt of the lock-in letter. In this case, the employer must withhold in accordance with the lock-in letter as of the date specified in the lock-in letter, which cannot be any earlier than 45 calendar days after the date of issuance of the lock-in letter.

After the lock-in letter becomes effective, the IRS may issue a subsequent notice (modification notice) modifying the lock-in letter. Generally, a modification notice is issued only after the employee contacts the IRS to request an adjustment to the withholding prescribed in the lock-in letter. In certain cases, if warranted,

¹ Special rules under §31.3402(g)-1 of the current regulations apply to “supplemental wages”. In the case of supplemental wages in excess of \$1,000,000, employers must disregard the entries on the employee's Form W-4 and apply a mandatory flat rate of withholding. In the case of supplemental wages of less than \$1,000,000, employers may either disregard the entries on the employee's Form W-4 and withhold using the optional flat rate or may use an aggregate procedure, taking into consideration the entries on the Form W-4 furnished by the employee.

the IRS may issue a notice releasing the employee from the lock-in program. If the employee is subject to a lock-in letter or modification notice, the employer may put in effect a Form W-4 only if doing so results in more withholding than specified by the lock-in letter or modification notice. Finally, an employee who was subject to a lock-in letter or modification notice, who terminates employment and then resumes employment with the same employer within 12 months of termination, remains subject to the lock-in letter or the modification notice withholding instructions upon resuming the employment.

TCJA changes

Prior to the Tax Cuts and Jobs Act, Pub. L. 115-97, 131 Stat. 2054 (2017) (TCJA), one withholding exemption was equal to the amount of one personal exemption provided in section 151(b), prorated to the payroll period. *See* section 3402(a)(2) (2017). TCJA enacted section 151(d)(5), which reduced the personal exemption amount to zero for the years 2018–2025. *See* TCJA section 11041(a). TCJA also increased the standard deduction under section 63, increased the child tax credit under section 24, and created a new credit under section 24 for other dependents. *See* TCJA sections 11021 and 11022.

TCJA permanently modified the wage withholding rules in section 3402(a)(2) and, replaced “withholding exemptions” with a “withholding allowance, prorated to the payroll period.” *See* TCJA section 11041(c)(1). TCJA also repealed section 3401(e), which, prior to TCJA, provided, for purposes of chapter 24 (relating to collection of income tax at source on wages), that the “number of withholding exemptions claimed” meant the number of withholding exemptions claimed in a withholding exemption certificate in effect under section 3402(f) or in effect under the corresponding section of prior law, except that if no such certificate was in effect, the number of withholding exemptions claimed was considered zero. *See* TCJA section 11041(c)(2)(A).

TCJA modified section 3402(f), and defined a “withholding allowance,” which is determined based on the factors listed in section 3402(f)(1). *See* TCJA section 11041(c)(2)(B). TCJA further changed the

list of factors on which the withholding allowance is based and added that the withholding allowance is determined based on rules determined by the Secretary. *See* TCJA section 11041(c)(2)(B). This change to section 3402(f)(1) revised section 3402(f)(1)(C), entitling an employee to take into account the number of individuals for which the employee expects to take an income tax credit under section 24 instead of the number of individuals with respect to whom the employee reasonably expects to claim a deduction under section 151. Section 3402(f)(1)(D) also changed an employee’s entitlement to take into account the standard deduction from an amount generally equal to one withholding exemption to the standard deduction allowable to such employee (one-half of the standard deduction in the case of an employee who is married and whose spouse is an employee receiving wages subject to withholding). Finally, TCJA added section 3402(f)(1)(F), which provides that the employee’s withholding allowance also takes into account “whether the employee has withholding allowance certificates in effect with respect to more than one employer.” *See* TCJA section 11041(c)(2)(B).

TCJA also made conforming changes to the “change of status” rules in section 3402(f)(2), changing “withholding exemptions” to “withholding allowance” and striking out “exemption” and inserting “allowance” in various subsections of section 3402. This resulted in a conforming change to the statutory name of the withholding exemption certificate in section 3402(f)(5) to the withholding allowance certificate. *See* TCJA sections 11041(c)(2)(B) and (C).

TCJA amended section 3402(m) by changing the reference from “withholding allowances” to “withholding allowance.” *See* TCJA sections 11041(c)(2)(D) and (E).

TCJA added the section 199A deduction to the list of deductions in section 3402(m)(1) that an employee may take into account in determining the additional withholding allowance that the employee is entitled to claim on Form W-4, and struck the reference to section 62(a)(10) in section 3402(m)(1) with respect to certain payments made under divorce or separation instruments previously described

in section 62(a)(10). *See* TCJA sections 11011(b)(4) and 11051(b)(2)(B).

The legislative history of TCJA states that “the Secretary of the Treasury is to develop rules to determine the amount of tax required to be withheld by employers from a taxpayer’s wages.” H.R. Rep. No. 115-466, at 203 (2017).

Guidance addressing TCJA

TCJA allowed the Secretary of the Treasury to administer section 3402 before January 1, 2019, without regard to the changes described above. *See* TCJA section 11041(f)(2). Nevertheless, on January 11, 2018, the Treasury Department and the IRS released Notice 1036, “Early Release Copies of the 2018 Percentage Method Tables for Income Tax Withholding,” which implemented TCJA’s tax rate changes, standard deduction, and suspension of the deduction under section 151. The Treasury Department and the IRS designed the 2018 withholding tables to work with the Forms W-4 that employees had already furnished their employers. On February 28, 2018, the Treasury Department and the IRS updated Form W-4, “Employee’s Withholding Allowance Certificate,” incorporating TCJA’s changes in the 2018 Form W-4’s worksheets and updated the online withholding calculator (now called the Tax Withholding Estimator) to reflect TCJA changes. Notice 2018-14, 2018-7 I.R.B. 353, published February 12, 2018, allowed continued use of the 2017 Form W-4 temporarily in 2018 and included a relief provision for employees who experienced changes in their tax circumstances solely attributable to TCJA.

Notice 2018-92, 2018-51 I.R.B. 1038, published December 17, 2018, addressed some of TCJA’s changes to section 3402 and provided interim rules for the 2019 calendar year. Section 3 of Notice 2018-92 addressed TCJA’s use of “withholding allowance” (singular) and provided that withholding allowances (plural) were to be used for wage withholding computational procedures in 2019. Under section 3 of Notice 2018-92, any reference to a withholding exemption in the regulations and other guidance under section 3402 was to be applied as if it were a reference to a withholding allowance. Section 4 of Notice 2018-92 extended the relief pro-

vided in Notice 2018-14 for changes in tax circumstances solely attributable to TCJA. Section 5 of Notice 2018-92 addressed the repeal of section 3401(e) and provided rules for employees who fail to furnish a valid Form W-4. Section 6 of Notice 2018-92 allowed employees to include the employee's estimated deduction under section 199A in determining the additional withholding allowance under section 3402(m) that the employee is entitled to claim on Form W-4. Section 7 of Notice 2018-92 allowed taxpayers to use the online withholding calculator (now called the Tax Withholding Estimator) or Publication 505, "Tax Withholding and Estimated Tax," in lieu of the Form W-4 worksheets. Section 8 of Notice 2018-92 requested comments on alternative withholding methods under section 3402(h) and announced that the IRS and the Treasury Department intended to eliminate the combined income tax withholding and employee Federal Insurance Contributions Act (FICA) tax withholding tables under §31.3402(h)(4)-1(b). Section 9 of Notice 2018-92 confirmed that an employer in receipt of a lock-in letter should not send a response to the IRS when the employer no longer employs the employee (within the meaning of §31.3402(f)(2)-1(g)(2)(iii)).

2019 Form W-4

In June 2018, the Treasury Department and the IRS released a draft 2019 Form W-4 and draft instructions for public comment. The 2019 draft Form W-4 and instructions incorporated significant changes intended to improve the accuracy of income tax withholding and make the withholding system more transparent for employees. Many comments were received on the draft form and instructions. In response to comments received from stakeholders, the Treasury Department and the IRS announced on September 20, 2018, that implementation of the redesigned form would be postponed until 2020, and that the Treasury Department and the IRS would continue working closely with stakeholders as additional changes were made to the form for 2020. For 2019, however, Notice 2018-92 announced that the 2019 Form W-4 would include minimal changes to the 2018 Form

W-4 and would continue to apply section 3402 by using the existing withholding system under which employees claimed a number of withholding allowances on a valid Form W-4.

In addition, the amount of each withholding allowance for 2019, like for the years before it, was set to what would have been the value of a personal or dependency exemption under section 151(b) prior to enactment of TCJA. *See* Rev. Proc. 2018-57, 2018-49 I.R.B. 827, sections 2.03 and 3.25. For calendar years 2018 through 2025, however, the exemption amount is zero. *See* section 151(d)(5)(A). Moreover, the high value of each withholding allowance (\$4,050 for 2017, \$4,150 for 2018, and \$4,200 for 2019) led to rounding errors that made it difficult for some employees to have their withholding equal their tax liability for the year. Accuracy was even more difficult to achieve for employees claiming tax credits, as these amounts first had to be converted into tax deductions and then expressed as a number of withholding allowances. In addition to limiting accuracy, the use of withholding allowances to compute withholding is not intuitive, given that wages, deductions, credits, and taxes are all expressed as dollar amounts, rather than as a number of withholding allowances. Although the 2019 or earlier Forms W-4 allowed an employee to achieve a high degree of accuracy if the employee requested an additional dollar amount to be withheld and/or used the online withholding calculator (now called the Tax Withholding Estimator) or Publication 505 in completing the Form W-4, most employees did not use these options.

Redesigned Form W-4, Employee's Withholding Certificate

To address the limitations of the 2019 Form W-4, on May 31, 2019, a draft of a redesigned 2020 Form W-4 was released for public comment. The redesigned Form W-4 was intended to reduce the combined complexity of the form, instructions, and worksheets and to increase the transparency and accuracy of the withholding system. The redesigned Form W-4 uses the same underlying information as the 2019 Form W-4 but replaces complex worksheets with more straightforward

questions. The redesigned Form W-4 was released on December 4, 2019, and then was rereleased on December 31, 2019, to reflect a change in the medical expense deduction threshold under section 213 for 2020 made by the Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94, 133 Stat. 2534, 3228 (2019).

The redesigned Form W-4 does not use withholding allowances. An employee selects a filing status (single, married filing separately, head of household, married filing jointly, or qualifying widow(er)) on the Form W-4, and this entry generally results in the basic standard deduction relating to the filing status being taken into account in determining the amount of tax withheld from the employee's pay. In addition, the redesigned Form W-4 streamlines the multiple jobs procedures and gives employees three options to account for a working spouse or multiple jobs held concurrently. Specifically, employees may (1) use the Tax Withholding Estimator to achieve accurate withholding; (2) complete the Multiple Jobs Worksheet and enter an additional amount to withhold from pay for each pay period; or (3) check the box in Step 2(c) on the redesigned Form W-4 to request withholding using higher withholding rate tables. For married taxpayers filing jointly with two jobs held concurrently, the effect of checking the box in Step 2(c) is similar to selecting "Married, but withhold at higher Single rate" on a 2019 or earlier Form W-4. The redesigned Form W-4 also allows an employee to enter dollar amounts for tax credits, other income, and deductions the employee expects to claim on his or her income tax return to reflect the permitted allowance under sections 3402(f)(1)(C) and (f)(1)(D) and the increase in the amount of withholding under section 3402(i).

Publication 15-T, Federal Income Tax Withholding Methods

On June 7, 2019, the IRS released for public comment a draft of Publication 15-T, "Federal Income Tax Withholding Methods," which provided percentage method tables, wage bracket withholding tables, and other computational procedures for employers to use to compute withholding for employees for the 2020 calendar year, including for employees

who furnished a redesigned Form W-4 to be effective for 2020. After stakeholder feedback, Publication 15-T was revised and rereleased on August 13, 2019, and was rereleased on November 4, 2019. Publication 15-T was finalized and released on December 24, 2019.

Publication 15-T prescribes percentage method tables, wage bracket withholding tables, discussion on alternative withholding methods, and Tables for Withholding on Distributions of Indian Gaming Profits to Tribal Members. These tables and discussions, which were formerly published in Publication 15 (Circular E), “Employer’s Tax Guide,” Publication 15-A, “Employer’s Supplemental Tax Guide,” and Publication 51, “Agricultural Employer’s Tax Guide,” are now published only in Publication 15-T, “Federal Income Tax Withholding Methods.” However, in 2020, the IRS discontinued publishing Formula Tables for Percentage Method Withholding (for Automated Payroll Systems), Wage Bracket Percentage Method Tables (for Automated Payroll Systems), and Combined Federal Income Tax, Employee Social Security Tax, and Employee Medicare Tax Withholding Tables. In addition, the IRS has discontinued publishing Notice 1036, “Early Release Copies of the Percentage Method Tables for Income Tax Withholding,” effective beginning with calendar year 2020, and instead will post information previously included in Notice 1036 in early release drafts of Publication 15 (www.irs.gov/Pub15) and Publication 15-T (www.irs.gov/Pub15T) for use by employers and the payroll community. For percentage method and wage bracket withholding tables, Publication 15-T describes different withholding computational procedures and different tables for 2019 or earlier Forms W-4 than for Forms W-4 from 2020 or later (the redesigned Forms W-4).

Notice of Proposed Rulemaking

On February 13, 2020, a notice of proposed rulemaking (proposed regulations) (REG-132741-17) was published in the Federal Register (85 FR 8344) to update the regulations under sections 3401 and 3402 for legislative changes, including TCJA, and expand the rules in the regulations to accommodate the changes nec-

essary to fully implement the redesigned Form W-4 and its related computational procedures, along with most existing computational procedures applicable to 2019 or earlier Forms W-4. These changes are explained in detail in the preamble to the proposed regulations.

The IRS did not receive any requests for a public hearing on the proposed regulations, and therefore no public hearing was held. Written comments responding to the proposed regulations were received and are available for public inspection and copying at <http://www.regulations.gov> or upon request. After full consideration of the comments received on the proposed regulations, this Treasury decision adopts the proposed regulations with revisions as described in the Summary of Comments and Explanation of Revisions.

Summary of Comments and Explanation of Revisions

The Treasury Department and the IRS received seven written comments in response to the proposed regulations. Some of the comments propose changes to the Form W-4 or related instructions, publications, or other guidance that would not require a change to the proposed regulations themselves. One commenter made a general comment about the complexity of income tax withholding from wages but did not offer any comments specific to the proposed regulations. Except to the extent that the comments raise issues related to the proposed regulations, the comments are beyond the scope of the proposed regulations, and therefore are not addressed in this Summary of Comments and Explanation of Revisions. However, the comments will remain under consideration for future revisions to forms, instructions, publications, and other guidance relating to income tax withholding from wages, including revisions to the Form W-4.

1. Requirement to maintain two systems to determine withholding

Two commenters expressed concern that the proposed regulations and the related forms, instructions, publications, and other guidance require maintenance of two different systems for computing income tax withholding from wages: one

system for 2019 or earlier Forms W-4, and another system for redesigned Forms W-4. According to these commenters, these two systems complicate computer programming and exacerbate inaccuracy of employees’ withholding determined using 2019 or earlier Forms W-4. These commenters requested that all employees should be required to furnish a redesigned Form W-4. One commenter stated that requiring all employees to furnish a redesigned Form W-4 would simplify computer programming and make employees more aware of TCJA changes to the wage withholding rules. The other commenter stated that not requiring employees to furnish a redesigned Form W-4 would increase burden on employers and would confuse employees who commence employment with a second or third employer that pays wages subject to income tax withholding for which the employee has to complete a redesigned Form W-4 while the employee still has 2019 or earlier Form(s) W-4 in effect with one or more employers.

The Treasury Department and the IRS note that section 3402(f)(4) generally requires that a Form W-4 continue in effect with respect to an employer until another Form W-4, furnished by the employee, takes effect under the rules in section 3402. Thus, an employer must continue withholding according to the Form W-4 submitted by an employee until the employee furnishes the employer a new Form W-4. In addition, section 11041 of TCJA does not require all employees to submit new Forms W-4 to conform to changes to the wage withholding rules in TCJA. In contrast, section 1581 of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2085, 2101 (1987), explicitly required all employees to furnish new Forms W-4 as a result of the changes made to the statute. In other words, although TCJA and the Tax Reform Act of 1986 both enacted significant changes to the income tax withholding rules in chapter 1, only the Tax Reform Act of 1986 mandated that employees furnish new Forms W-4. Therefore, the final regulations do not require all employees with a 2019 or earlier Form W-4 in effect to furnish a redesigned Form W-4.

Nevertheless, the Treasury Department and the IRS acknowledge the commenters’ concerns and address them in two

ways: (1) through instructions to the redesigned Form W-4 for employees with multiple jobs and (2) through optional computational “bridge” entries permitted under these regulations and described in Publication 15-T.

First, in redesigning the Form W-4, the Treasury Department and the IRS were aware of the challenges facing employees who have multiple employers paying wages subject to withholding and who have 2019 or earlier Form(s) W-4 in effect in completing the redesigned Form W-4. The redesigned 2020 Form W-4 includes instructions advising employees that, “[t]o be accurate, submit a 2020 Form W-4 for all other jobs.” The IRS intends to continue providing an updated version of this instruction on Forms W-4 for future years.

Second, to address commenters’ concerns relating to employers maintaining separate withholding systems, these regulations adopt optional computational bridge entries that will allow employers to continue in effect 2019 or earlier Forms W-4 as if the employees had furnished redesigned Forms W-4. This will allow employers to use one process for both 2019 and earlier Forms W-4 and 2020 and later Forms W-4 and free employers from the need to use the number of allowances data field from 2019 and earlier Forms W-4 once the employers apply the appropriate computational bridge entries for their employees. Accordingly, starting for calendar year 2021, the IRS intends to include instructions in Publication 15-T for these optional computational bridge entries. The computational bridge entries will allow employers to use the computational procedures and data fields for the redesigned Form W-4 to arrive at the equivalent withholding for an employee that would have applied using the computational procedures and data fields related to a 2019 or earlier Form W-4 furnished by the employee.

Specifically, Publication 15-T will provide for four adjustments to accurately implement the computational bridge entries. First, Publication 15-T will provide

for treating an employee as having made an entry on line 1(c) (filing status) of the redesigned Form W-4 that most accurately reflects the employee’s entry on line 3 (marital status) of a 2019 or earlier Form W-4. In this regard, an employee will be treated as having selected “single or married filing separately” on the redesigned form if the employee selected either “single” or “married, but withhold at higher single rate” on a 2019 or prior Form W-4. An employee will be treated as having selected “married filing jointly” on the redesigned form if the employee selected “married” on a 2019 or prior Form W-4.

Second, Publication 15-T will provide for treating an employee as also having made an entry in step 4(a) (other income (not from jobs)) on the redesigned Form W-4 based on the marital status on line 3 of a 2019 or earlier Form W-4 to help offset the full basic standard deduction that has otherwise been incorporated in tables related to the various filing statuses in step 1(c) of the redesigned Form W-4. In particular, the employer would treat the employee as having entered the value of two allowances corresponding to a single employee’s filing status and the value of three allowances corresponding to a married employee’s filing status in Step 4(a) of the redesigned Form W-4.

Third, Publication 15-T will provide for treating an employee as having made an entry in step 4(b) (deductions) of the redesigned Form W-4 to replicate the effect of allowances claimed on line 5 (number of allowances) of a 2019 or earlier Form W-4. In particular, the employer would multiply the number of allowances claimed on line 5 of a 2019 or earlier Form W-4 by \$4,300 and treat the employee as having entered the product in Step 4(b) of the redesigned Form W-4.

Finally, fourth, Publication 15-T will provide for treating an employee as having made an entry in step 4(c) (extra withholding) of the redesigned Form W-4 to replicate the effect of any additional amount that the employee requested to have withheld using line 6 (additional

amount withheld from each paycheck) on a 2019 or earlier Form W-4. In particular, the employer would treat the employee as having entered any additional amount the employee requested to have withheld from each paycheck on line 6 of a 2019 or earlier Form W-4 in Step 4(c) of the redesigned Form W-4.²

To facilitate the use of the computational bridge entries, starting in 2021, the IRS will no longer index the withholding allowance to reflect cost-of-living adjustments to what would have been the value of a personal or dependency exemption in section 151(b) prior to enactment of TCJA. The withholding allowance will be fixed at \$4,300 in 2021. Thus, employers that choose to implement the computational bridge entries starting in 2021 will not have to make any adjustments to employees’ withholding entries that the employee is treated as having made on the redesigned Form W-4 within their system unless the employee furnishes a new, redesigned Form W-4.

For example, for the year 2021 and its withholding allowance of \$4,300, an employer determining withholding from wages for an employee with a 2019 Form W-4 in effect on which the employee reported a marital status of single (or married, but withhold at a higher single rate) and one withholding allowance would compute withholding for the employee as if the employee had made the following entries on a 2021 Form W-4: single or married filing separately in Step 1(c) (filing status), an entry of \$8,600 in Step 4(a) (other income (not from jobs)) and an entry of \$4,300 in Step 4(b) (deductions) to determine withholding from wages for this employee. In this case, the computational bridge entries that the employee is treated as having made in Step 1(c), Step 4(a), and Step 4(b) of the 2021 Form W-4 replicate the effect of selecting single and one withholding allowance on the 2019 Form W-4.

Use of the computational bridge entries will be optional; the IRS intends to continue publishing withholding tables and

²For employers that use the computational bridge entries for nonresident alien employees with 2019 or earlier Forms W-4 in effect, the procedures in Publication 15-T will provide for an entry on the redesigned form to replicate the effect of allowances claimed on a 2019 or earlier Form W-4, as well as an entry for any additional amount the nonresident alien requested to be withheld on a 2019 or earlier Form W-4. Publication 15-T will instruct employers that choose to use the computational bridge entries for nonresident alien employees with a 2019 or earlier Form W-4 in effect to apply the general procedures applicable to nonresident alien employees who furnish a redesigned Form W-4.

procedures for employers that choose to continue computing withholding using the computational procedures related to 2019 or earlier Forms W-4 furnished by employees. The computational bridge entries apply only for Forms W-4 that were properly put in effect on or before December 31, 2019, and that continue in effect under section 3402(f)(4). The computational bridge entries are not intended to continue 2019 or earlier computational procedures, including the use of a number of withholding allowances, for redesigned Forms W-4. Furthermore, if an employee is either required, or chooses, to furnish a new Form W-4, the use of the computational bridge entries by an employer does not change the requirement that the employee must use the current year's revision of the Form W-4 when furnishing a new Form W-4 to his or her employer.³

Accordingly, these final regulations revise §31.3402(f)(4)-1(a) to provide that an employer's use of the computational bridge entries to adapt a 2019 or earlier Form W-4 to the redesigned computational procedures as if using entries on a redesigned Form W-4 will continue in effect, within the meaning of section 3402(f)(4), a 2019 or earlier Form W-4 that was properly in effect on or before December 31, 2019.

2. Lock-in letters or modification notices

One commenter expressed concern about whether a lock-in letter under which an employer is required to withhold based on instructions using 2019 or earlier Form W-4 computational procedures ceases to be effective because of the redesign of the Form W-4 until a new lock-in letter using redesigned Form W-4 computational procedures is issued to the employer. Under current regulations, once an employer is required to furnish the employee a copy of the lock-in letter, the lock-in letter becomes effective. It remains effective until the IRS issues the employer a modification notice, including a modification notice releasing the employee from a lock-in letter or a prior modification notice, or until the employee furnishes the employer a Form W-4 that requests more withhold-

ing than required under the lock-in letter or modification notice. If the employee is no longer employed by the employer, the lock-in letter generally does not apply because the employer generally is not paying wages subject to withholding. Under the proposed regulations and these final regulations, employers are no longer required to notify the IRS that they no longer employ an employee for whom a lock-in letter was issued.

These final regulations follow the proposed regulations and do not require the IRS to reissue lock-in letters or modification notices solely because of the redesign of the Form W-4. Employers may not assume that a lock-in letter or modification notice ceases to be effective because of changes resulting from the redesigned Form W-4 and related withholding procedures. Unless the employee furnishes the employer a Form W-4 that results in more withholding than under the lock-in letter or modification notice, the employer must continue following any lock-in letter or modification notice until the IRS releases the employee from the program.

For ease of administering the withholding instructions in lock-in letters or modification notices that were based on 2019 or earlier Forms W-4, employers may use the optional computational bridge entries discussed in section 1 of this Summary of Comments and Explanation of Revisions to comply with the requirement to withhold based on the maximum withholding allowance and filing status permitted in a lock-in letter or modification notice and to adapt to the redesigned Form W-4 and computational procedures. For example, for calendar year 2021, based on a withholding allowance of \$4,300, an employer that is determining withholding from wages for an employee subject to a lock-in letter that uses 2019 computational procedures and instructs the employer use a filing status of single and a maximum withholding allowance of zero allowances, may comply with the lock-in letter by using the following computational bridge entries on a 2021 Form W-4: an entry of single or married filing separately in Step 1(c), an entry of \$8,600 in Step 4(a) (other in-

come (not from jobs)) to further account for the effect of the withholding instructions directing an employer to withhold from the employee using the single filing status, and an entry of \$0 in Step 4(b) (deductions) to replicate the effect of the employee's maximum withholding allowance of zero withholding allowances.

These final regulations revise the rules in §31.3402(f)(2)-1(g)(2)(iv) (relating to lock-in letters) and (vii) (relating to modification notices) to provide that an employer may comply with a lock-in letter or modification notice that is based on a 2019 or earlier Form W-4, as required by the regulations, if the employer implements the maximum withholding allowance and filing status permitted in a lock-in letter or modification notice by using the computational bridge entries as set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner to calculate withholding for a 2019 or earlier Form W-4.

Another commenter stated that lock-in letters and modification notices should be revised in such a way that makes it easier for employers to compare withholding based on a lock-in letter or modification notice to withholding based on the redesigned Form W-4. Specifically, this commenter notes that the new entries on the redesigned Form W-4 make it more difficult for employers to determine whether a newly furnished Form W-4 results in more withholding than a lock-in letter or modification notice that the employer was required to put in effect. The commenter's suggestions regarding the contents of the lock-in letters or modifications notices do not require changes to the proposed regulations because the language of the proposed regulations is broad enough to accommodate the commenter's suggestions to the letters and notices. Accordingly, the proposed regulations regarding the contents of the lock-in letter or modification notice will be adopted as final without change. However, these comments will be considered in future revisions of the lock-in letter and modification notice.

Furthermore, to ease the employer's burden in determining whether a Form

³Near the end of a year, an employee may furnish the Form W-4 revision for the following calendar year to take effect for the following calendar year.

W-4 furnished by an employee for whom a lock-in letter or modification notice is in effect results in more withholding (and thus may be put into effect), the Treasury Department and the IRS note that employers may use the Income Tax Withholding Assistant for employers available on www.irs.gov. The Income Tax Withholding Assistant can aid in estimating the amount of tax to be withheld from employee's wages based on a Form W-4 furnished by the employee, which can be compared to the withholding required pursuant to a lock-in letter or modification notice. The Income Tax Withholding Assistant is a software tool that is designed to help small employers with manual payroll systems compute the amount of income tax to withhold from employees' wages. Employers enter the employees' pay frequency, wages, and Form W-4 entries, and the software tool computes the amount of income tax that is required to be withheld from employees' wages. This software tool is compatible with 2019 or earlier Forms W-4, as well as with the 2020 Form W-4, and is designed to be used by employers that use the income tax withholding tables in Publication 15-T.

The same commenter also suggested that employees who are subject to a lock-in letter or modification notice be restricted from making certain entries on a Form W-4 that they furnish to an employer that must withhold pursuant to a lock-in letter or modification notice. However, because each entry on Form W-4 is intended to foster accuracy and simplicity in income tax withholding, an employee who is subject to a lock-in letter or modification notice should be able to use all entries on Form W-4 when appropriate. Due to the circumstances under which a lock-in letter or modification notice is issued (i.e., the employee's history of noncompliance with withholding requirements), and that any decrease in withholding from a lock-in letter or modification notice may only be accomplished by seeking a modification notice from the IRS, the employee would be furnishing a redesigned Form W-4 only to request an increase in withholding.

3. Effective period of a withholding allowance certificate

The proposed regulations provide that when an employee is released from a lock-in letter or modification notice, the employee would generally be required to furnish a new Form W-4, and if the employee fails to do so, the employee would be treated as single but having the withholding allowance provided in forms, instructions, publications, and other guidance prescribed by the Commissioner that applies to other employees who fail to furnish a new Form W-4.⁴ Under the redesigned computational procedures, this means that the employee would be treated as single or married filing separately in Step 1(c) of the 2020 Form W-4 with no entries in Step 2, Step 3, or Step 4.

One commenter recommended that this rule be modified to require an employee to furnish a new Form W-4, but, in the event the employee fails to do so, the withholding according to the lock-in letter or modification notice would continue. The commenter recommended this approach to reduce the administrative burden on employers in administering lock-in letters and modification notices, especially upon the employee's release from a lock-in letter or modification notice. After careful consideration of the comment, the Treasury Department and the IRS do not agree that this approach is appropriate. To foster accuracy, the Treasury Department and IRS are of the view that an employee released from a lock-in letter should be subject to the normal default rule until the employee furnishes a new Form W-4. Accordingly, these final regulations adopt the rule in §31.3402(f)(4)-1 as set forth in the proposed regulations.

4. Head of household filing status

One commenter questioned whether employees who were eligible for the head of household filing status but claimed single filing status on a 2019 or earlier Form W-4 must be withheld as head of household using tables applicable to redesigned

Forms W-4. Under the proposed regulations, the adoption of the head of household filing status and the use of related tables is limited to redesigned Forms W-4. The head of household filing status and related tables are not available for 2019 or earlier Forms W-4. These final regulations adopt the filing status rules set forth in the proposed regulations.

5. Amount of income tax withheld using the redesigned Form W-4

One commenter noted that in processing 2020 Forms W-4 for employees, it appeared that no tax would be withheld from employees' pay, in certain circumstances, such as when employees enter an amount in Step 3 to reflect the child or other dependent credits. The commenter further noted that it appeared that no tax would be withheld in these circumstances despite the Tax Withholding Estimator showing that the employee would have a tax liability. The Treasury Department and the IRS cannot comment on specific factual situations; however, the Treasury Department and the IRS note that the redesigned Form W-4 is intended to result in more accurate withholding.

Prior to the redesign of the Form W-4, approximately 30% of income tax returns that reported gross income from wages did not report any income tax liability, yet approximately 93% of these taxpayers with no income tax liability still had federal income tax withheld from wages. Accordingly, the redesigned Form W-4 was designed to consider all the deductions and credits an employee is entitled to, which often results in no income tax withholding from the employee's wages. This is consistent with the goal of increased accuracy in withholding, which includes minimizing overwithholding from employees who owe little or no income tax, especially after tax credits reduce the employees' income tax liability.

6. Estimated Tax Payments

Under the proposed regulations, employees who are not subject to a lock-in

⁴ If the employee's Form W-4 results in more withholding than prescribed by the lock-in letter or modification notice, the proposed regulations provide that the employer should continue withholding according to the employee's Form W-4, even after the employee is released from the lock-in letter or modification notice.

letter or modification notice may take into account estimated tax payments already made, provided that they take into account nonwage income and follow the instructions to the Tax Withholding Estimator. Although no comments were received on this issue, the Treasury Department and the IRS have determined that certain employees, especially those employees with a higher amount of nonwage income relative to wage income, should also be able to take into account planned estimated tax payments not yet made provided that the employee (1) takes into account all wage and nonwage income in determining withholding, (2) follows the instructions to the Tax Withholding Estimator, and (3) does not use planned estimated tax payments to reduce income tax withholding from wages below the pro-rata share of chapter 1 income tax attributable to the estimated annual wages. The pro-rata share of chapter 1 tax attributable to estimated annual wages will be determined under forms, instructions, publications, and other guidance prescribed by the Commissioner. The Treasury Department and the IRS have determined that this rule furthers accuracy in withholding without encouraging inappropriate underwithholding on wages by shifting withholding from wages to estimated tax payments.

In addition, the Treasury Department and the IRS have determined that employees who do not use the Tax Withholding Estimator and instead use IRS Publication 505 to determine their withholding should be able to take into account estimated tax payments subject to the applicable requirements, provided that the employees use Publication 505 instructions. Accordingly, these final regulations revise §31.3402(m)-1(d) to allow employees to take into account estimated tax payments provided that the employee (1) follows the instructions to the Tax Withholding Estimator or Publication 505, (2) is not subject to a lock-in letter or modification notice, and (3) does not request withholding from wages that falls below the pro rata share of chapter 1 taxes attributable to wages as determined under forms, instructions, publications, and other guidance prescribed by the Commissioner. The IRS intends to update the Tax Withholding Estimator and Publication 505 to reflect this rule.

7. *Applicability Date*

Consistent with the applicability date provisions in the proposed regulations, these final regulations generally apply on and after October 6, 2020. However, as in the proposed regulations, §31.3402(f)(2)-1(g), relating to withholding compliance, applies as of February 13, 2020, the date the notice of proposed rulemaking was published in the Federal Register; §31.3402(f)(5)-1(a)(3), regarding the requirement to use the current version of Form W-4, applies as of March 16, 2020, 30 days after the date the notice of proposed rulemaking was published in the Federal Register; and the removal of §31.3402(h)(4)-1(b), relating to the combined income tax withholding and employee FICA tax withholding tables, applies on and after January 1, 2020. Except with regard to the removal of §31.3402(h)(4)-1(b), taxpayers may also choose to apply the final regulations, on and after January 1, 2020 and before their applicability date as set forth in the regulations. See section 7805(b)(7).

Special Analyses

I. *Regulatory Planning and Review*

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

II. *Regulatory Flexibility Act*

Under the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that these final regulations do not have a significant economic impact on a substantial number of small entities that are directly affected by these final regulations. These final regulations will apply to all employers that have an income tax withholding obligation and, therefore, are likely to affect a substantial number of small entities. Although these final regulations are likely to affect a substantial number of small entities, the economic impact of these final regulations will not be significant.

These final regulations do not independently impact employers or employees because these final regulations support both the 2019 and 2020 Form W-4 and related withholding procedures, and employees are not required to furnish a new Form W-4 solely because of the redesign of the Form W-4. Employees who have a Form W-4 on file with their employer from years prior to 2020 generally will continue to have their withholding determined based on that form. These final regulations incorporate the changes made by TCJA to sections 3401 and 3402 and provide flexible and administrable rules for income tax withholding from wages to implement the 2020 Form W-4 and its related tables and computational procedures described in Publication 15-T and to work with 2019 or earlier Forms W-4. Any economic impact on small entities that have an income tax withholding obligation is generally a result of the change in underlying substantive tax rules which led to revisions in the method of computing withholding, not these final regulations. Because the final regulations preserve the option of continuing to use old Forms W-4 for existing employees who have not had significantly changed circumstances, and provide for optional computational bridge entries for employers to facilitate continued use of Forms W-4 provided in 2019 or earlier years that eliminates the need for employers to maintain separate withholding systems, these final regulations minimize impact of the statutory changes on employers, including small entities. Accordingly, the Treasury Department and the IRS certify that these final regulations will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

III. *Paperwork Reduction Act*

Any collection of information associated with these final regulations has been

submitted to the Office of Management and Budget for review under OMB control number 1545-0074 in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). In general, the collection of information is required under section 3402 of the Internal Revenue Code. The Treasury Department and the IRS request comments on all aspects of information collection burdens related to these final regulations, including estimates for how much time it would take to comply with the paperwork burdens described in OMB control number 1545-0074 and ways for the IRS to minimize the paperwork burden. An agency may not conduct or sponsor and a person is not required to respond to a collection of information unless it displays a valid OMB control number.

IV. *Unfunded Mandates Reform Act*

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

V. *Executive Order 13132: Federalism*

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

Statement of Availability of IRS Documents

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 web site at <http://www.irs.gov>.

Drafting Information

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

Employment taxes, Fishing vessels, Gambling, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 is amended by adding an entry for §31.3402 in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805.

Section 31.3402 also issued under 26 U.S.C. 3402(i) and (m).

§31.3401(e)-1 [Removed]

Par. 2. Section 31.3401(e)-1 is removed.

Par. 3. Section 31.3402(a)-1 is amended by adding paragraphs (g) and (h) to read as follows:

§31.3402(a)-1 Requirement of withholding.

(g) For purposes of chapter 24 of the Code and this subpart:

(1) References to “withholding exemption certificate” include “withholding allowance certificate” unless otherwise stated in this subpart.

(2) [Reserved]

(h) The provisions of paragraph (g) of this section apply on and after October 6, 2020. Taxpayers may choose to apply paragraph (g) of this section on or after January 1, 2020 and before October 6, 2020.

Par. 4. Section 31.3402(b)-1 is revised to read as follows:

§31.3402(b)-1 Percentage method of withholding.

(a) *Percentage method of withholding.* The amount of tax to be deducted and withheld from an employee’s wages under the percentage method of withholding is determined based on the entry for the employee’s anticipated filing status or marital status and other entries on the employee’s withholding allowance certificate using the applicable percentage method tables and computational procedures set forth in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner issued with respect to the period in which wages are paid.

(b) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 5. Section 31.3402(c)-1 is amended:

1. By revising paragraph (a)(1).
2. By redesignating paragraph (a)(2) as paragraph (a)(3).
3. By adding a new paragraph (a)(2).
4. By revising paragraph (b).
5. In paragraph (c)(1), by revising the first sentence.
6. By adding paragraph (f).
7. By removing the parenthetical authority citation at the end of the section.

The revisions and additions read as follows:

§31.3402(c)-1 Wage bracket withholding.

(a) * * *

(1) The employer may elect to use the wage bracket method provided in section 3402(c) instead of the percentage method with respect to any employee. The tax computed under the wage bracket method shall be in lieu of the tax required to be deducted and withheld under section 3402(a).

(2) The amount of tax to be deducted and withheld from an employee's wages under the wage bracket method of withholding is determined based on the entry for the employee's anticipated filing status or marital status and other entries on the employee's withholding allowance certificate using the applicable wage bracket method tables and computational procedures set forth in the applicable forms, instructions, publications, and other guidance prescribed by the Commissioner issued with respect to the period in which wages are paid.

* * * * *

(b) *Established payroll periods, other than daily or miscellaneous, covered by wage bracket withholding tables.* The wage bracket withholding tables applicable to the employee's filing status set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner for established periods other than daily or miscellaneous should be used in determining the tax to be deducted and withheld for any such period without reference to the time the employee is actually engaged in the performance of services during such payroll period.

(c) * * *

(1) * * * The tables applicable to a daily or miscellaneous payroll period show the tentative amount of tax to be deducted and withheld from an employee's wages for the employee's filing status for one day. * * *

* * * * *

(f) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply this section on or after January 1, 2020 and before October 6, 2020. For rules that

apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 6. Section 31.3402(f)(1)-1 is revised to read as follows:

§31.3402(f)(1)-1 Withholding allowance.

(a) *In general.* (1) Except as otherwise provided in section 3402(f)(6) (see §31.3402(f)(6)-1), an employee receiving wages will, on any day, be entitled to a withholding allowance as provided in section 3402(f)(1) and paragraph (b) of this section. In order to receive the benefit of the withholding allowance, the employee must furnish to the employer a valid withholding allowance certificate in effect for the calendar year as provided in section 3402(f)(2) and §31.3402(f)(2)-1.

(2) The employer is not required to ascertain whether the withholding allowance claimed is greater than the withholding allowance to which the employee is entitled. For rules relating to invalid withholding allowance certificates, see §31.3402(f)(2)-1(f)(3), for rules relating to required submission of copies of certain withholding allowance certificates to the Internal Revenue Service, see §31.3402(f)(2)-1(g)(1), and for rules relating to the notice of the maximum withholding allowance permitted, see §31.3402(f)(2)-1(g)(2).

(b) *Withholding allowance defined.*

(1) Generally, the withholding allowance to which an employee is entitled is determined under the computational procedures prescribed by the Commissioner in forms, instructions, publications, and other guidance for the calendar year for which the withholding allowance certificate is in effect.

(2) The withholding allowance is determined based on the following—

(i) Whether the employee is an individual for whom a deduction is allowable with respect to another taxpayer under section 151;

(ii) If the employee is married, whether the employee's spouse is an individual for whom a deduction is allowable with respect to another taxpayer under section 151 but only if such spouse does not have in effect a withholding allowance certificate claiming such deduction;

(iii) If the employee is married, whether the employee's spouse is entitled to ad-

ditional deductions, credits, or other items the employee elects to take into account under §31.3402(m)-1 or would be so entitled if the employee's spouse were an employee receiving wages, but only if such spouse does not have in effect a withholding allowance certificate claiming such allowance;

(iv) Any credit under section 24(a) that the employee reasonably expects to be able to claim on the employee's income tax return for the calendar year for which the withholding allowance certificate is in effect, except that the employee may not take into account any credit under section 24(a) if this credit is claimed on another valid withholding allowance certificate in effect with respect to another employer of the employee or the employee's spouse. In addition, an employee whose employer must withhold for that employee pursuant to a notice under §31.3402(f)(2)-1(g)(2) must offset any tax benefit resulting from a credit under section 24(a) with any anticipated income tax attributable to items other than wages includible in the employee's gross income in the manner prescribed by the Commissioner;

(v) Any additional deductions, credits, or other items the employee elects to take into account under §31.3402(m)-1 for the calendar year for which the withholding allowance certificate is in effect;

(vi) The basic standard deduction (as defined in section 63(c)(2)) relating to the filing status the employee reasonably expects to claim on the employee's income tax return for the calendar year for which the withholding allowance certificate is in effect; and

(vii) Any adjustment resulting from multiple withholding allowance certificates the employee, the employee's spouse, or both have or reasonably expect to have in effect with respect to one or more employers, determined based on the instructions to the withholding allowance certificate and other guidance for the calendar year for which the withholding allowance certificate is in effect.

(c) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 7. Section 31.3402(f)(2)-1 is revised to read as follows:

§31.3402(f)(2)-1 Furnishing of withholding allowance certificates.

(a) On commencement of employment.

(1) On or before the date on which an individual commences employment with an employer, the individual must furnish the employer with a signed withholding allowance certificate (see §31.3402(f)(5)-1) relating to the filing status the employee reasonably expects to claim under §31.3402(l)-1(b) for the calendar year for which the withholding allowance certificate is in effect and the withholding allowance under §31.3402(f)(1)-1(b) that the employee claims.

(2) In no event may the withholding allowance exceed the withholding allowance that the employee is entitled to as determined based on the employee's reasonable expectations and the instructions set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner.

(3) The employee may claim exemption from withholding if the certifications described in section 3402(n) and §31.3402(n)-1(a)(1) and (2) are true with respect to the employee.

(4) If an employee has no valid withholding allowance certificate in effect with the employer at the time of the payment of the wages, and fails to furnish a valid withholding allowance certificate to the employer, the employee will be treated as single but having the withholding allowance provided in forms, instructions, publications, and other guidance prescribed by the Commissioner.

(b) Change of status that affects calendar year—(1) General rule. If, on any day during the calendar year, the employee experiences a change of status that reduces the employee's withholding allowance or withholding allowances, in the manner described in paragraph (b)(2) of this section, the employee must, within 10 days after the change occurs, furnish the employer with a new withholding allowance certificate claiming the withholding allowance to which the employee is entitled under §31.3402(f)(1)-1(b), unless paragraph (b)(3) of this section applies to the employee.

(2) Changes of status. A change of status occurs if any of the following changes occur on any day during the calendar year:

(i) The employee's filing status changes in the manner described in §31.3402(l)-1(c).

(ii) The employee no longer has only one withholding allowance certificate in effect for the employee, the employee's spouse, or both, and the employee or the employee's spouse selects higher withholding rate tables on the additional withholding allowance certificate, but higher withholding rate tables are not selected on any previously furnished withholding allowance certificate.

(iii) The employee has multiple withholding allowance certificates in effect on which higher withholding rate tables are not selected, and the employee or the employee's spouse reasonably expects an increase in regular wages for the calendar year (as defined in §31.3402(g)-1(a)(1)(ii)) in excess of \$10,000.

(iv) The employee has included on a valid withholding allowance certificate the child tax credit allowed under section 24(a) but reasonably expects the number of individuals who satisfy the definition of "qualifying child" as defined in section 24(c) who will be reported on the employee's income tax return for the year for which tax is being withheld to be less than the number taken into account in completing the withholding allowance certificate.

(v) The employee has included on a valid withholding allowance certificate a tax credit allowed under section 24(a) or other tax credits allowed under §31.3402(m)-1 but reasonably expects the employee's tax credits that will be reported on the employee's income tax return for the year for which tax is being withheld to decrease by more than \$500 from the amount taken into account in completing the withholding allowance certificate.

(vi) The employee has included on a valid withholding allowance certificate deductions allowed under §31.3402(m)-1 but reasonably expects the employee's included income tax deductions that will be reported on the employee's income tax return for the year for which tax is being withheld to decrease by more than \$2,300 from the amount taken into account in completing the withholding allowance certificate.

(vii) It is no longer reasonable for an employee who has furnished the employer with a withholding allowance certificate which relies upon the certifications described in §31.3402(n)-1(a) to anticipate that the employee will incur no liability for income tax imposed under subtitle A of the Code for the current or previous taxable year.

(3) Exception. If one or more of the changes described in paragraph (b)(2) of this section occurs, but the total effect of the changes together with any other changes affecting the employee's anticipated tax liability under subtitle A is not anticipated to result in an amount of tax to be deducted and withheld from the employee's wages under section 3402 for the year that is less than the employee's anticipated tax liability under subtitle A, the employee is not required to furnish a new withholding allowance certificate.

(c) Increase in withholding allowance. If, on any day during the calendar year, the employee experiences a change of status that increases the employee's withholding allowance, the employee may furnish the employer with a new withholding allowance certificate claiming the withholding allowance the employee is entitled to under §31.3402(f)(1)-1(b).

(d) Exemption from withholding. If, on any day during the calendar year, the certifications described in section 3402(n) and §31.3402(n)-1(a)(1) and (2) are true with respect to an employee, the employee may furnish the employer with a withholding allowance certificate claiming exemption from withholding in the manner described in forms, instructions, publications, and other guidance prescribed by the Commissioner.

(e) Change of status which affects next calendar year—(1) General rule. If, on any day during the calendar year, the withholding allowance to which the employee will be, or may reasonably be expected to be, entitled under §31.3402(f)(1)-1(b) for the next calendar year, but not for the current calendar year, decreases in the manner prescribed in paragraph (b)(2) of this section, the employee must furnish a new withholding allowance certificate claiming the withholding allowance the employee is entitled to under §31.3402(f)(1)-1(b) to take effect in the next calendar year by the later of December 1 of the cal-

endar year of the year in which the change occurs or within 10 days after the change occurs, unless paragraph (e)(2) of this section applies to the employee.

(2) *Exception.* If one or more of the changes in paragraph (b)(2) of this section occurs, but the total effect of the changes together with any other changes affecting the employee's anticipated tax liability under subtitle A is not anticipated to result in an amount of tax to be deducted and withheld from the employee's wages under section 3402 for the employee's next year that is less than the employee's anticipated tax liability under subtitle A, the employee is not required to furnish a new withholding allowance certificate.

(f) *Special rules*—(1) *Employer requests.* Before December 1 of each year, every employer should request each employee to furnish a new withholding allowance certificate for the next calendar year, in the event of a change to the employee's withholding allowance.

(2) *Social security account numbers.* Every individual to whom a social security number has been assigned must include such number on any withholding allowance certificate furnished to an employer. An employee may not use a truncated social security number (see §301.6109-4 of this chapter) in completing the withholding allowance certificate. For provisions relating to the obtaining of an account number from the Social Security Administration, see §31.6011(b)-2.

(3) *Invalid withholding allowance certificates*—(i) *General rule.* Any alteration of or unauthorized addition to a withholding allowance certificate causes such certificate to be invalid; see §31.3402(f)(5)-1(b) for the definitions of alteration and unauthorized addition. Any withholding allowance certificate which the employee clearly indicates to be false by an oral statement or by a written statement (other than one made on the withholding allowance certificate itself) made by the employee to the employer on or before the date on which the employee furnishes such certificate is also invalid. For purposes of the preceding sentence, the term "employer" includes any individual authorized by the employer either to receive withholding allowance certificates, to make withholding computations, or to make payroll distributions.

(ii) *Employer disregard of invalid withholding allowance certificate.* If an employer receives an invalid withholding allowance certificate, the employer must disregard it for purposes of computing withholding. The employer must inform the employee who furnished the certificate that it is invalid and must request another withholding allowance certificate from the employee. If the employee who furnished the invalid certificate fails to comply with the employer's request, the employer must treat the employee as single but having the withholding allowance provided by the forms, instructions, publications, and other guidance prescribed by the Commissioner. If, however, a prior certificate is in effect with respect to the employee, the employer must continue to withhold in accordance with the prior certificate.

(g) *Submission of certain withholding allowance certificates and notice of maximum withholding allowance permitted*—(1) *Submission of certain withholding allowance certificates*—(i) *In general.* An employer must submit to the Internal Revenue Service (IRS) a copy of any currently effective withholding allowance certificate as directed in a written notice to the employer from the IRS or as directed in published guidance.

(A) *Notice to submit withholding allowance certificates.* A notice to the employer to submit withholding allowance certificates may relate either to one or more named employees, to one or more reasonably segregable units of the employer, or to withholding allowance certificates under certain specified criteria. The notice will designate the IRS office to which the copies of the withholding allowance certificates must be submitted. Alternatively, upon notice from the IRS, the employer must make available for inspection by an IRS employee withholding allowance certificates received from one or more named employees, from one or more reasonably segregable units of the employer, or from employees who have furnished withholding allowance certificates under certain specified criteria.

(B) *Published guidance.* Employers may also be required to submit copies of withholding allowance certificates under certain specified criteria when directed to do so by the IRS in published guid-

ance in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(ii) *Withholding after submission of withholding allowance certificate.* After a copy of a withholding allowance certificate has been submitted to the IRS under this paragraph (g)(1), the employer must withhold tax on the basis of the withholding allowance certificate, if the withholding allowance certificate meets the requirements of §31.3402(f)(5)-1. However, the employer may not withhold on the basis of the withholding allowance certificate if the certificate must be disregarded based on a notice of the maximum withholding allowance permitted under the provisions of paragraph (g)(2) of this section.

(2) *Notice of the maximum withholding allowance permitted*—(i) *Notice to employer.* The IRS may notify the employer in writing that the employee is not entitled to claim a complete exemption from withholding or more than the maximum withholding allowance specified by the IRS in the written notice. The notice will also specify the applicable filing status for purposes of calculating the required amount of withholding. The notice will specify the IRS office to be contacted for further information. The notice of maximum withholding allowance permitted may be issued if—

(A) The IRS determines that a copy of a withholding allowance certificate submitted under paragraph (g)(1) of this section or otherwise provided to the IRS includes a materially incorrect statement or determines, after a request to the employee for verification of the statements on the certificate, that the IRS lacks sufficient information to determine if the certificate is correct; or

(B) The IRS otherwise determines that the employee is not entitled to claim a complete exemption from withholding and is not entitled to claim more than a specified number of withholding exemptions, withholding allowances, or a specified withholding allowance.

(ii) *Notice to employee.* If the IRS provides a notice to the employer under this paragraph (g)(2), the IRS will also provide the employer with a similar notice for the employee (employee notice) that identifies the maximum withholding allowance permitted and specifies the filing status to be

used for calculating the required amount of withholding for the employee. The employee notice will indicate the process by which the employee can provide additional information to the IRS for purposes of determining the appropriate withholding allowance and/or modifying the specified filing status. The IRS will also mail a similar notice to the employee's last known address. For further guidance regarding the definition of last known address, see §301.6212-2 of this chapter. If the IRS is unable to determine a last known address for the employee, the IRS will use other available information as appropriate to mail the notice to the employee.

(iii) *Requirement to furnish.* If the employee is employed by the employer as of the date of the notice, the employer must furnish the employee notice to the employee within 10 business days of receipt. The employer may follow any reasonable business practice to furnish the copy of the notice to the employee. For purposes of this paragraph (g)(2)(iii), the determination of whether an employee is employed as of the date of the notice is based on all the facts and circumstances, including whether the employer has treated the employment relationship as terminated for other purposes. An employee who is not performing services for the employer as of the date of the notice is employed by the employer as of the date of the notice for purposes of this paragraph (g)(2)(iii) if—

(A) The employer pays wages with respect to prior employment to the employee subject to income tax withholding on or after the date specified in the notice;

(B) The employer reasonably expects the employee to resume the performance of services for the employer within twelve months of the date of the notice; or

(C) The employee is on a bona fide leave of absence and either the period of such leave does not exceed twelve months or the employee retains a right to re-employment with the employer under an applicable statute or by contract.

(iv) *Requirement to withhold based on the notice.* If the employer is required to furnish the employee notice to the employee under paragraph (g)(2)(iii) of this section, then the employer must withhold tax on the basis of the maximum withholding allowance and the filing status specified in the notice for any wages paid

after the date specified in the notice, except as provided in paragraphs (g)(2)(v) through (ix) of this section. The employer must withhold tax in accordance with the notice as of the date specified in the notice, which shall be no earlier than 45 calendar days after the date of the notice. If the notice was provided to the employer based on computational procedures applicable to a withholding allowance certificate that was in effect on December 31, 2019 or earlier, the employer may comply with the requirement in this paragraph (g)(2)(iv) to withhold on the basis of the notice by implementing the maximum withholding allowance and filing status permitted by using the computational bridge entries as set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner to calculate withholding for a withholding allowance certificate that was in effect on December 31, 2019 or earlier.

(v) *Employment resumes after twelve months.* If the employer is required to furnish the employee notice to the employee only pursuant to paragraph (g)(2)(iii)(B) of this section and the employee resumes the performance of services for the employer more than 12 months after the date of the notice, then the employer is not required to withhold based on the notice.

(vi) *Requirement to withhold based on an existing Form W-4.* If a withholding allowance certificate is in effect with respect to the employee before the employer receives a notice of the maximum withholding allowance permitted under this paragraph (g)(2), the employer must continue to withhold tax in accordance with the existing withholding allowance certificate, rather than on the basis of the notice, if the existing withholding allowance certificate does not claim complete exemption from withholding and claims a filing status, a withholding allowance, and any additional amount under §31.3402(i)-1(a)(1) and (2) that results in more withholding than would result from applying the filing status and withholding allowance specified in the notice.

(vii) *Modification notice.* After issuing the notice specifying the maximum withholding allowance permitted and the filing status, the IRS may issue a subsequent notice to the employer and the employee that modifies the original notice

(modification notice). The modification notice may change the filing status and/or the withholding allowance permitted. The employer must withhold based on the modification notice as of the date specified in the modification notice. If the modification notice was provided to the employer based on computational procedures applicable to a withholding allowance certificate that was in effect on December 31, 2019 or earlier, the employer may comply with the requirement in this paragraph (g)(2)(vii) to withhold on the basis of the modification notice by implementing the maximum withholding allowance and filing status permitted by using the optional computational bridge entries as set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner to calculate withholding for a withholding allowance certificate that was in effect on December 31, 2019 or earlier.

(viii) *Requirement to withhold after termination of employment.* If the employee is employed as of the date of the notice under paragraph (g)(2)(iii) of this section but the employer or employee terminates the employment relationship after the date of the notice, the employer must continue to withhold based on the maximum withholding allowance and the filing status specified in the notice or a modification notice if any wages subject to income tax withholding are paid with respect to the prior employment after such date. Furthermore, the employer must withhold based on the notice or modification notice if the employee resumes an employment relationship with the employer within 12 months after the termination of the employment relationship. Whether the employment relationship is terminated is based on all the facts and circumstances.

(ix) *Requirement to withhold based on new Form W-4.* The employee may furnish a new withholding allowance certificate after the employer receives a notice or modification notice from the IRS of the maximum withholding allowance permitted under this paragraph (g)(2).

(A) *Employee requests more withholding.* If the employee furnishes a new withholding allowance certificate after the employer receives the notice or modification notice, the employer must withhold tax on the basis of that new certificate only if the

new certificate does not claim complete exemption from withholding and claims a filing status, a withholding allowance, and any additional amount under §31.3402(i)-1(a)(1) and (2) that results in more withholding than would result under the notice or modification notice.

(B) *Employee requests less withholding.* If the employee furnishes a new withholding allowance certificate after the employer receives the notice or modification notice, the employer must disregard the new certificate and withhold on the basis of the notice or modification notice if the employee claims complete exemption from withholding or claims a filing status, a withholding allowance, and any additional amount under §31.3402(i)-1(a)(1) and (2) that results in less withholding than would result under the notice or modification notice. If the employee wants to put a new certificate into effect that results in less withholding than that required under the notice or modification notice, the employee must contact the IRS. The employer must withhold on the basis of the notice or modification notice unless the IRS subsequently notifies the employer to withhold based on the new certificate.

(3) *Definition of employer.* For purposes of this paragraph (g), the term “employer” includes any person authorized by the employer to receive withholding allowance certificates, to make withholding computations, or to make payroll distributions.

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

(i) *Example 1.* Employer U receives a notice from the IRS that identifies the maximum withholding allowance permitted and specifies the filing status for Employee A. Employee A is not currently performing any services for Employer U. However, Employer U is continuing to make certain wage payments to Employee A. Employer U must furnish the employee notice to Employee A within 10 business days of receipt and must withhold based on the notice on any wages paid to Employee A on or after the date specified in the notice.

(ii) *Example 2.* Employer V receives a notice in October of Year 1 from the IRS that identifies the maximum withholding allowance permitted and specifies the filing status for Employee B. Employee B has not performed services for Employer V since August of Year 1. However, since Employee B has performed services for Employer V for several years on a seasonal basis, Employer V reasonably expects Employee B to resume the performance of services for Employer V in June of Year 2, a date that is within 12 months of the date of the notice. Employer V is

required to furnish the notice to Employee B within 10 business days of receipt. Employee B does not resume the performance of services with Employer V until June of Year 3. Employer V is not required to withhold based on the notice.

(iii) *Example 3.* Employer W receives a notice from the IRS that identifies the maximum withholding allowance permitted and specifies the filing status for Employee C. Employee C began a 4-month unpaid maternity leave of absence three weeks before Employer W received the notice. Employer W must furnish the employee notice to Employee C within 10 business days of receipt. When her maternity leave ends and Employee C resumes performing services for Employer W, Employer W must withhold based on the notice.

(iv) *Example 4.* Employer X receives a notice from the IRS in Year 1 that identifies the maximum withholding allowance permitted and specifies the filing status for Employee D. Employer X must furnish the employee notice to Employee D within 10 business days of receipt and withhold based on the notice. In Year 2, Employee D terminates the employment relationship. Employee D applies for a different position with Employer X and resumes employment 10 months after having left her previous position with Employer X. Since Employer X rehired Employee D within 12 months after the termination of employment, Employer X must withhold based on the notice.

(v) *Example 5.* Employer Y receives a notice from the IRS that identifies the maximum withholding allowance permitted and specifies the filing status for Employee E. Employer Y must furnish the employee notice to Employee E within 10 business days of receipt. After receipt of this notice, Employee E contacts the IRS and establishes that the employee is entitled to claim a modified filing status and withholding allowance. Employer Y receives a modification notice from the IRS that changes the maximum withholding allowance permitted for Employee E. Employer Y must withhold tax based on the modification notice as of the date specified in such notice.

(vi) *Example 6.* Employer Z pays remuneration to Employee F, a United States citizen, for services performed in Country M. Employer Z receives a notice from the IRS in Year 1 that identifies the maximum withholding allowance permitted and specifies the filing status for Employee F. Employer Z must furnish the employee notice to Employee F within 10 business days of receipt. Employer Z reasonably believes all the remuneration paid to Employee F in Year 1 is excluded from Employee F’s gross income under section 911. Since section 3401(a)(8)(B) excludes such remuneration from wages for income tax withholding purposes, Employer X does not have to withhold on such remuneration, notwithstanding the maximum withholding allowance permitted and filing status specified in the notice. In Year 2, Employee F returns to the United States to perform services. Employer Z does not reasonably believe any part of Employee F’s remuneration paid in Year 2 is excluded from Employee F’s gross income under section 911. Rather, Employer Z reasonably believes that remuneration paid to Employee F in Year 2 is subject to income tax withholding. Employer Z must withhold on the remuneration paid to Employee F in Year 2 based on the notice.

(h) *Applicability date.* The provisions of paragraph (g) of this section apply on February 13, 2020. Taxpayers may choose to apply paragraph (g) of this section on or after January 1, 2020 and before February 13, 2020. For rules that apply under paragraph (g) of this section before February 13, 2020, see 26 CFR part 31, revised as of April 1, 2020. The provisions of paragraphs (a) through (f) of this section apply on and after October 6, 2020. Taxpayers may choose to apply the provisions of paragraph (a) through (f) of this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 8. Section 31.3402(f)(3)-1 is revised to read as follows:

§31.3402(f)(3)-1 When withholding allowance certificate takes effect.

(a) *No withholding allowance certificate on file.* A withholding allowance certificate furnished to the employer in any case in which no previous withholding allowance certificate is in effect with such employer, takes effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

(b) *Withholding allowance certificate on file.* Except as provided in paragraph (c) of this section, a withholding allowance certificate furnished to the employer in any case in which a previous withholding allowance certificate is in effect with such employer takes effect as of the beginning of the first payroll period ending (or the first payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished. However, the employer may elect to put a withholding allowance certificate into effect earlier, beginning with any payment of wages on or after the day on which the certificate is so furnished.

(c) *Withholding allowance certificate furnished to take effect in next calendar year.* A withholding allowance certificate furnished to the employer pursuant to section 3402(f)(2)(C) (see §31.3402(f)(2)-1(e) or §31.3402(l)-1(c)) which effects a

change for the next calendar year, does not take effect, and may not be made effective, with respect to the calendar year in which the certificate is furnished.

(d) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

§31.3402(f)(4)-1 [Removed]

Par. 9. Section 31.3402(f)(4)-1 is removed.

§31.3402(f)(4)-2 [Redesignated as §31.3402(f)(4)-1]

Par. 10. Section 31.3402(f)(4)-2 is redesignated as §31.3402(f)(4)-1.

Par. 11. Newly redesignated §31.3402(f)(4)-1 is revised to read as follows:

§31.3402(f)(4)-1 Effective period of a withholding allowance certificate.

(a) *In general.* Except as provided in paragraph (b) of this section and §31.3402(f)(2)-1(g)(2), a withholding allowance certificate that takes effect under section 3402(f) of the Internal Revenue Code of 1986 continues in effect with respect to the employee until another withholding allowance certificate takes effect under section 3402(f). An employer's use of computational bridge entries as set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner to calculate withholding for a withholding allowance certificate that was in effect on December 31, 2019 or earlier continues in effect an employee's withholding allowance certificate under this paragraph (a).

(b) *Certifications under section 3402(n) eliminating requirement of withholding.* The certifications described in §31.3402(n)-1(a) made by an employee with respect to the employee's preceding taxable year and current taxable year are effective until either a new withholding allowance certificate furnished by the employee takes effect or the existing certificate that relies upon such certifications ex-

pires. If an employee's certificate expires and the employee fails to furnish a valid withholding allowance certificate, the employee will be treated as single but having the withholding allowance provided in forms, instructions, publications, and other guidance prescribed by the Commissioner. In no case shall a withholding allowance certificate that relies upon such certifications be effective with respect to any payment of wages made to an employee:

(1) In the case of an employee whose liability for tax under subtitle A of the Code is determined on a calendar year basis, after February 15 of the calendar year following the estimation year; or

(2) In the case of an employee to whom paragraph (b)(1) of this section does not apply, after the 15th day of the 2nd calendar month following the last day of the estimation year.

(c) *Estimation year.* The estimation year is the taxable year including the day on which the employee furnishes the withholding allowance certificate to the employer, except that if the employee furnishes the withholding allowance certificate to the employer and specifies on the certificate that the certificate is not to take effect until a specified future date, the estimation year will be the taxable year including that specified future date.

(d) *Applicability to notice of maximum withholding allowance.* If a withholding allowance certificate is no longer in effect because of the application of §31.3402(f)(2)-1(g)(2), the employer is no longer required to withhold pursuant to any notice under §31.3402(f)(2)-1(g)(2), and the employee fails to furnish the employer a valid withholding allowance certificate, then the employee will be treated as single but having the withholding allowance provided in forms, instructions, publications, and other guidance prescribed by the Commissioner, in accordance with §31.3402(f)(2)-1(a)(4).

(e) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 12. Section 31.3402(f)(5)-1 is revised to read as follows:

§31.3402(f)(5)-1 Form and contents of withholding allowance certificates.

(a) *In general—(1) Form W-4.* Form W-4, "Employee's Withholding Certificate," previously called "Employee's Withholding Allowance Certificate," is the form prescribed for the withholding allowance certificate required to be furnished under section 3402(f)(2). A withholding allowance certificate must be prepared in accordance with the instructions applicable thereto and must set forth fully and clearly the information that is called for therein. In lieu of the prescribed form, an employer may prepare and provide to employees a form the provisions of which are identical to those of the prescribed form, but only if the employer also provides employees with all the tables, instructions, and worksheets set forth in the Form W-4 in effect at that time, and only if the employer complies with all revenue procedures and other guidance prescribed by the Commissioner relating to substitute forms in effect at that time.

(2) *Employee substitute forms.* Employers are prohibited from accepting a substitute form developed by an employee, and an employee furnishing such form will be treated as failing to furnish a withholding allowance certificate. For further guidance regarding the employer's obligations when an employee is treated as failing to furnish a withholding allowance certificate, see §31.3402(f)(2)-1.

(3) *Current year revision.* Only the Form W-4 revision in effect for a calendar year may be furnished by an employee in that calendar year and given legal effect by the employer, unless provided otherwise in forms, instructions, publications, or other guidance, except that an employee may furnish the Form W-4 revision for the following calendar year in the current calendar year to take effect for the following calendar year.

(4) *Examples.* The following examples illustrate the rule in paragraph (a)(3) of this section.

(i) *Example 1.* Employee A furnishes a 2019 Form W-4 to Employer X in calendar year 2020. The 2019 Form W-4 furnished by Employee A in 2020 has no legal effect. Employer X must disregard this 2019 Form W-4 furnished in 2020 and continue to

withhold based on a previously furnished Form W-4 that has been in effect for Employee A, if any. If Employee A has no Form W-4 in effect, she is treated as having no valid withholding allowance certificate in effect.

(ii) *Example 2.* Employee A furnishes a 2021 Form W-4 to Employer X in calendar year 2020 to take effect in calendar year 2021. The 2021 Form W-4 is valid, and the employer must put this form into effect in 2021 in accordance with the timing rules in §31.3402(f)(3)-1.

(b) *Invalid Form W-4.* A Form W-4 does not meet the requirements of section 3402(f)(5) or this section and is invalid if it includes an alteration or unauthorized addition. For purposes of §31.3402(f)(2)-1(f)(3) and this paragraph (b)—

(1) An alteration of a withholding allowance certificate is any deletion of the language of the jurat or other similar provision of such certificate by which the employee certifies or affirms the correctness of the completed certificate, or any material defacing of such certificate; and

(2) An unauthorized addition to a withholding allowance certificate is any writing on such certificate other than the entries requested on the Form W-4 (e.g., name, address, and filing status) or permitted by instructions or other guidance. For purposes of this paragraph (b)(2), an entry claiming exemption from withholding that is accompanied by other entries on the Form W-4 (other than the employee's filing status) that could potentially affect the amount of income tax deducted and withheld from the employee's pay is an unauthorized addition; consequently, the employer must treat the Form W-4 as an invalid Form W-4.

(c) *Electronic Form W-4*—(1) *In general.* An employer may establish a system for its employees to furnish withholding allowance certificates electronically.

(2) *Requirements*—(i) *In general.* The electronic system must ensure that the information received is the information sent and must document all occasions of employee access that result in the furnishing of a Form W-4. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and furnishing the Form W-4 is the employee identified in the form.

(ii) *Information to employer.* The electronic furnishing must provide the employer with exactly the same information as the current version of the official In-

ternal Revenue Service (IRS) Form W-4 available on irs.gov.

(iii) *Information to employee.* The electronic Form W-4 system must provide the employee with the same information as the current version of the official IRS Form W-4 available on irs.gov and must satisfy any requirements specified by the IRS in forms, publications, and other guidance. The electronic Form W-4 system must provide employees the ability to claim exemption from withholding under section 3402(n) and must include the two certifications described in §31.3402(n)-1(a).

(iv) *Jurat and signature requirements.* The electronic furnishing must be signed by the employee under penalties of perjury.

(A) *Jurat.* The jurat (perjury statement) must contain the language that appears on the paper Form W-4. The electronic program must inform the employee that he or she must make the declaration set forth in the jurat and that the declaration is made by signing the Form W-4. The instructions and the language of the jurat must immediately follow the employee's income tax withholding selections and immediately precede the employee's electronic signature.

(B) *Electronic signature.* The electronic signature must identify the employee furnishing the electronic Form W-4 and authenticate and verify the furnishing. For purposes of this paragraph (c)(2)(iv) (B), the terms "authenticate" and "verify" have the same meanings as they do when applied to a written signature on a paper Form W-4. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the employee's Form W-4 furnished electronically.

(v) *Copies of electronic Forms W-4.* Upon request by the Internal Revenue Service, the employer must supply a hard copy of the electronic Form W-4 and a statement that, to the best of the employer's knowledge, the electronic Form W-4 was furnished by the named employee. The hardcopy of the electronic Form W-4 must provide exactly the same information as, but need not be a facsimile of, the paper Form W-4.

(d) *Applicability date.* The provisions of paragraphs (a)(3) and (4) of this section

apply on and after March 16, 2020. Taxpayers may choose to apply the provisions of paragraphs (a)(3) and (4) of this section on or after January 1, 2020 and before March 16, 2020. For the provision of paragraph (a)(3) of this section that applies before March 16, 2020, see 26 CFR part 31, revised as of April 1, 2020. The provisions of paragraphs (a)(1) and (2), (b), and (c) of this section apply on and after October 6, 2020. Taxpayers may choose to apply paragraphs (a)(1) and (2), (b), and (c) of this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 13. Section 31.3402(f)(6)-1 is revised to read as follows:

§31.3402(f)(6)-1 Withholding exemptions for nonresident alien individuals.

(a) *In general.* (1) A nonresident alien individual (other than a nonresident alien individual treated as a resident under section 6013(g) or (h)) subject to withholding under section 3402 is on any one day entitled to the number of withholding exemptions corresponding to the number of personal exemptions to which the nonresident alien is entitled on such day by reason of the application of section 873(b)(3) or section 876, whichever applies. Thus, a nonresident alien individual who is not a resident of Canada or Mexico and who is not a resident of Puerto Rico during the entire taxable year, is allowed only one withholding exemption.

(2) The withholding exemption in paragraph (a) of this section and section 3402(f)(6) is the deduction allowed to the nonresident alien individual under section 151.

(b) *Additional guidance.* A nonresident alien individual (other than a nonresident alien individual treated as a resident under section 6013(g) or (h)) subject to withholding must follow administrative guidance such as forms, instructions, publications, or other guidance prescribed by the Commissioner to determine the nonresident alien's withholding allowance.

(c) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply this section on or after January 1, 2020 and before October 6, 2020. For rules that

apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 14. Section 31.3402(g)-1 is amended:

1. In paragraph (a)(2), by revising the second sentence.

2. In paragraph (a)(7)(ii), by revising the first sentence.

3. By adding paragraph (d).

The revisions and addition read as follows:

Sec. 31.3402(g)-1 Supplemental wage payments.

(a) * * *

(2) * * * This flat rate shall be applied without regard to whether income tax has been withheld from the employee's regular wages, and without regard to any entries on Form W-4, including whether the employee has claimed exempt status on Form W-4 or whether the employee has requested additional withholding on Form W-4, and without regard to the withholding method used by the employer. * * *

* * * * *

(7) * * *

(ii) * * * The determination of the tax to be withheld under paragraph (a)(7)(iii) of this section is made without reference to any payment of regular wages and without regard to any entries on the Form W-4 other than the entry claiming exempt status on Form W-4 (see §31.3402(n)-1(b)). * * *

* * * * *

(d) *Applicability date.* The provisions of paragraphs (a)(2) and (a)(7)(ii) of this section apply on and after October 6, 2020. Taxpayers may choose to apply paragraphs (a)(2) and (a)(7)(ii) of this section on or after January 1, 2020 and before October 6, 2020. For the provisions of paragraphs (a)(2) and (a)(7)(ii) of this section that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 15. Section 31.3402(h)(4)-1 is amended by:

1. Removing paragraph (b).

2. Redesignating paragraph (c) as paragraph (b).

3. Adding a new paragraph (c).

4. Removing the parenthetical authority citation at the end of the section.

The addition reads as follows:

§31.3402(h)(4)-1 Other methods.

* * * * *

(c) *Applicability date.* The removal of paragraph (b) from this section as of October 6, 2020, which provided for combined FICA and income tax withholding tables, applies on and after January 1, 2020. For rules that apply before January 1, 2020, see 26 CFR part 31, revised as of April 1, 2020.

§31.3402(i)-1 [Removed]

Par. 16. Section 31.3402(i)-1 is removed.

§31.3402(i)-2 [Redesignated as §31.3402(i)-1]

Par. 17. Section 31.3402(i)-2 is redesignated as §31.3402(i)-1.

Par. 18. Newly redesignated §31.3402(i)-1 is amended by:

1. Revising the section heading and paragraph (a)(2).

2. Adding paragraph (a)(3).

3. Revising paragraph (b).

4. Removing the parenthetical authority citation at the end of the section.

The revisions and addition read as follows:

§31.3402(i)-1 Increases in withholding.

(a) * * *

(2) *Increases in withholding based on additional income.* (i) The employee may request that the employer add an additional amount to the employee's wages and that the employer deduct and withhold an additional amount of income tax resulting from this addition under the computational procedures prescribed by the Commissioner in forms, instructions, publications, and other guidance for the calendar year for which the withholding allowance certificate claiming an additional amount to add to the employee's wages is furnished;

(ii) The employee may request that the employer deduct and withhold additional amounts of income tax resulting from the employee selecting higher withholding rate tables on the withholding allowance certificate;

(iii) The employer must comply with the employee's request under paragraph

(a)(1)(i) or (ii) of this section, except that the employer shall comply with the employee's request only to the extent that the amount that the employee requests to be deducted and withheld under this section does not exceed the amount that remains after the employer has deducted and withheld all amounts otherwise required to be deducted and withheld by Federal law (other than by section 3402(i) and this section), State law, and local law (other than by State or local law that provides for voluntary withholding); and

(iv) The employer must comply with the employee's request in accordance with the time limitations in §31.3402(f)(3)-1. The employee must make the request on Form W-4 as provided in §31.3402(f)(5)-1 (relating to form and contents of withholding allowance certificates), and this Form W-4 shall take effect and remain effective in accordance with section 3402(f) and §31.3402(f)(4)-1.

(3) *Amount deducted treated as tax.* The amount deducted and withheld pursuant to paragraphs (a)(1) and (2) of this section shall be treated as tax required to be deducted and withheld under section 3402.

(b) *Applicability date.* The provisions of paragraphs (a)(2) and (3) of this section apply on and after October 6, 2020. Taxpayers may choose to apply paragraphs (a)(2) and (3) this section on or after January 1, 2020 and before October 6, 2020.

Par. 18. Section 31.3402(l)-1 is revised to read as follows:

§31.3402(l)-1 Determination and disclosure of marital or filing status.

(a) *In general.* An employer shall apply the applicable percentage method or wage bracket method withholding tables corresponding to the marital status or filing status that the employee selects on a valid withholding allowance certificate as set forth in forms, instructions, publications, and other guidance prescribed by the Commissioner.

(b) *Employee's filing status.* An employee will be treated as single unless the employee selects head of household or married filing jointly filing status on a valid withholding allowance certificate. Employees may select a filing status other than single, subject to the following conditions:

(1) The employee may select head of household filing status on the employee's withholding allowance certificate only if the employee reasonably expects to be eligible to claim head of household filing status under section 2(b) and §1.2-2(b) of this chapter on the employee's income tax return.

(2) The employee may select married filing jointly filing status on the employee's withholding allowance certificate only if paragraph (d) of this section applies to the employee and the employee reasonably expects to file jointly a single return of income under subtitle A of the Code with the employee's spouse. If an employee is married and expects to file a separate return from the employee's spouse, the employee must select single or married filing separately filing status on the employee's withholding allowance certificate.

(c) *Change in filing status*—(1) *In general.* Unless paragraph (c)(2) of this section applies, the employee must within 10 days furnish the employer with a new withholding allowance certificate if the employee's filing status changes—

(i) From married filing jointly (or qualifying widow(er)) to head of household, married filing separately, or single; or

(ii) From head of household to married filing separately or single.

(2) *Exception.* If the employee's filing status changes in the manner described in paragraph (c)(1)(i) or (ii) of this section, but the total effect of the changes together with other changes affecting the employee's anticipated tax liability under subtitle A does not result in an amount of tax to be deducted and withheld from the employee's wages for the taxable year that is less than the employee's anticipated tax liability under subtitle A, the employee is not required to furnish a new withholding allowance certificate within 10 days. However, the employee must furnish a new withholding allowance certificate to take effect the following calendar year by the later of December 1 of the calendar year in which the employee's filing status changes, or within 10 days of such change.

(d) *Determination of marital status.* For the purposes of section 3402(l)(2) and paragraph (b) of this section, paragraphs (d)(1) and (2) of this section shall be ap-

plied in determining whether an employee is a single person or a married person:

(1) An employee shall on any day be considered as a single person and not married if—

(i) The employee is legally separated from the employee's spouse under a decree of divorce or separate maintenance; or

(ii) Either the employee or the employee's spouse is, or on any preceding day within the same calendar year was, a nonresident alien unless the employee has made or reasonably expects to make an election under section 6013(g) in the time and manner prescribed in §1.6013-6(a)(4) of this chapter.

(2) An employee shall on any day be considered as a married person if paragraph (d)(1) of this section does not apply and—

(i) The employee is married within the meaning of §301.7701-18(b) of this chapter on the day the withholding allowance certificate is furnished;

(ii) The employee's spouse died during the employee's taxable year; or

(iii) The employee's spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of the taxable year, to be a surviving spouse as defined in section 2 and §1.2-2(a) of this chapter. The employee must reasonably expect to file an income tax return claiming qualifying widow(er) status.

(e) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply paragraphs (a)(2) and (3) this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 20. Section 31.3402(m)-1 is revised to read as follows:

§31.3402(m)-1 Additional withholding allowance.

(a) *In general.* In determining the withholding allowance or additional reductions in withholding under section 3402(m) on employee withholding allowance certificates furnished to the em-

ployer to be effective on or after January 1, 2020, employees may take into account the estimated tax deductions described in paragraph (b) of this section, the estimated tax credits described in paragraph (c) of this section, and estimated tax payments described in paragraph (d) of this section. Employees may only claim items in paragraphs (b), (c), and (d) of this section to the extent provided in paragraph (e) of this section.

(b) *Estimated tax deductions.* Employees may take into account the following income tax deductions in chapter 1 of the Code:

(1) Estimated itemized deductions (as defined in section 63(d)) allowable under chapter 1;

(2) Estimated deductions described in section 62(a), except for—

(i) Any deduction described in section 62(a)(1);

(ii) Any deduction described in section 62(a)(2) if the reimbursement or payment for the amount allowable as such deduction is excludable from wages subject to income tax withholding;

(iii) Any deduction described in section 62(a)(3);

(iv) Any deduction described in section 62(a)(4); and

(v) Any deduction described in section 62(a)(5);

(3) Estimated deductions for net operating loss carryovers under section 172;

(4) The estimated aggregate net losses from schedules C (Profit or Loss from Business), D (Capital Gains and Losses), E (Supplemental Income and Loss), and F (Profit or Loss from Farming) of Form 1040 and from the last line of Part II of Form 4797 (Sale of Business Property);

(5) Estimated additional standard deduction for the aged and blind provided under section 63(c)(3) and section 63(f);

(6) Estimated deduction allowed under section 199A; and

(7) Estimated deduction or deductions allowed under section 151.

(c) *Estimated tax credits.* Employees may take into account the estimated income tax credits allowable under chapter 1, except for—

(1) The credit under section 31(a) for taxes withheld under chapter 24 of the Code (which includes taxes withheld on wages and amounts treated as wag-

es for chapter 24 purposes, such as pension withholding under section 3405 and backup withholding under section 3406) unless, on the day the employee estimates this amount, the amount has been actually withheld from the employee's wages (or another payment treated as wages for this purpose), the employee enters this amount of tax withheld pursuant to the instructions in the Tax Withholding Estimator (or successor) or Publication 505 (or successor), and the employee is not an employee whose employer must withhold for that employee pursuant to a notice under §31.3402(f)(2)-1(g)(2);

(2) The credit for tax withheld at source for nonresident aliens and foreign corporations under section 33; and

(3) Any credit to the extent that the employee has filed or expects to file any IRS form claiming such credit other than the employee's United States Individual Income Tax Return (Form 1040).

(d) *Estimated tax payments.* Employers may take into account estimated tax payments only if—

(1) The employee's employer is not obligated to withhold on the employee's wages pursuant to a notice under §31.3402(f)(2)-1(g)(2);

(2) The amount claimed has been paid with the payment voucher from Form 1040-ES (or was otherwise designated by the taxpayer as a payment of estimated tax) or is planned to be made with respect to nonwage items but only if the planned amount does not decrease withholding below the pro-rata share of chapter 1 tax attributable to wages as determined under forms, instructions, publications, and other guidance prescribed by the Commissioner;

(3) The employee uses the Tax Withholding Estimator (or successor) or Publication 505 (or successor) and enters the amount claimed pursuant to the instructions in the Tax Withholding Estimator (or successor) or Publication 505 (or successor); and

(4) In using the Tax Withholding Estimator (or successor) or Publication 505 (or successor), the employee includes all items of nonwage income the Tax Withholding Estimator (or successor) or Publication 505 (or successor) prompts or instructs the employee to enter or include.

(e) *Definitions and special rules—*(1) *Estimated.* The term "estimated" as used

in this section to modify the terms "deduction," "deductions," "credits," "losses," and "amount of decrease" means with respect to an employee the aggregate dollar amount of a particular item that the employee reasonably expects will be allowable to the employee on the employee's income tax return for the estimation year under the section of the Code specified for each item. In no event shall that amount exceed the sum of:

(i) The amount shown for that particular item on the income tax return that the employee has filed for the taxable year preceding the estimation year (or, if such return has not yet been filed, then the income tax return that the employee filed for the taxable year preceding such year), which amount the employee also reasonably expects to show on the income tax return for the estimation year; plus

(ii) The determinable additional amounts (as defined in paragraph (e)(1)(iii) of this section) for each item for the estimation year.

(iii) The determinable additional amounts are amounts that are not included in paragraph (e)(1)(i) of this section and that are demonstrably attributable to identifiable events during the estimation year or the preceding year. Amounts are demonstrably attributable to identifiable events if they relate to payments already made during the estimation year, to binding obligations to make payments (including the payment of taxes) during the year, and to other transactions or occurrences, the implementation of which has begun and is verifiable at the time the employee furnishes a withholding allowance certificate. The estimation year is the taxable year including the day on which the employee furnishes the withholding allowance certificate to the employer, except that if the employee furnishes the withholding allowance certificate to the employer and specifies on the certificate that the certificate is not to take effect until a specified future date, the estimation year shall be the taxable year including that specified future date. It is not reasonable for an employee to include in his or her withholding computation for the estimation year any amount that is shown for a particular item on the income tax return that the employee has filed for the taxable year preceding the estimation year (or, if

such return has not yet been filed, then the income tax return that the employee filed for the taxable year preceding such year) and that has been disallowed by the Service as part of an adjustment described in §601.103(b) of this chapter (relating to examination and determination of tax liability) and §601.105(b) through (d) of this chapter (relating to examination of returns), without regard to any pending request for reconsideration, protest, request for consideration by an Appeals office, or civil action in which such proposed adjustment is at issue.

(2) *Restriction for employees with non-wage income.* The employee must offset any deduction described in paragraph (b) of this section with items includible in the employee's gross income for which no Federal income tax is withheld in accordance with forms, instructions, publications, and other guidance prescribed by the Commissioner. In addition, an employee whose employer must withhold for that employee pursuant to a notice under §31.3402(f)(2)-1(g)(2) must offset any tax benefit resulting from any deduction or credit described in paragraph (b) or (c) of this section with the anticipated income tax attributable to items other than wages includible in the employee's gross income in the manner determined by the Commissioner.

(3) *Multiple withholding allowance certificates—*(i) *In general.* The employee may not take into account deductions, credits, or estimated tax payments described in paragraph (b), (c), or (d) of this section if these deductions, credits, or estimated tax payments are claimed on another valid withholding allowance certificate in effect with respect to another employer of the employee or any employer of the employee's spouse.

(ii) *Married taxpayers filing jointly.* Married taxpayers who reasonably expect to file as married filing jointly on their Federal income tax return for the estimation year determine the withholding allowance to which they are entitled under section 3402(m) on the basis of their combined wages, allowable credits or deductions, and estimated tax payments permitted to be taken into account. The deductions, credits, or estimated tax payments described in paragraphs (b), (c), and (d) of this section to which either spouse is entitled may be

claimed by either spouse or may be allocated between both spouses. However, one spouse may not claim deductions, credits, or estimated tax payments described in paragraphs (b), (c), and (d) of this section claimed on the other spouse's withholding allowance certificate.

(iii) *Married taxpayers filing separately.* A married taxpayer who reasonably expects to file a separate income tax return from the employee's spouse for the estimation year determines the withholding allowance deductions, credits, or estimated tax payments described in paragraphs (b), (c), and (d) of this section on the basis of the employee's individual wages, deductions, credits, and estimated tax payments.

(4) *IRS instructions.* An employee must follow the instructions to the Form W-4, and other IRS forms, instructions, publications, and related guidance in determining the employee's withholding allowance or other reductions in withholding permitted under section 3402(m) for deductions, credits, or estimated tax payments described in paragraphs (b), (c), and (d) of this section.

(f) *Applicability date.* The provisions of this section apply on or after October 6, 2020. Taxpayers may choose to apply paragraphs (a)(2) and (3) this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Par. 21. Section 31.3402(n)-1 is revised to read as follows:

§31.3402(n)-1 Employees incurring no income tax liability.

(a) *In general.* Notwithstanding any other provision of this subpart (except to the extent a payment of wages is subject to withholding under §31.3402(g)-1(a)(2)), an employer shall not deduct and withhold any tax under chapter 24 of the Code upon a payment of wages made to an employee, if there is in effect with respect to the payment a withholding allowance certificate furnished to the employer by the employee which certifies that—

(1) The employee incurred no liability for income tax imposed under subtitle A of the Internal Revenue Code for the employee's preceding taxable year; and

(2) The employee anticipates that the employee will incur no liability for income tax imposed under subtitle A for the employee's current taxable year.

(b) *Mandatory flat rate withholding.* To the extent wages are subject to income tax withholding under §31.3402(g)-1(a)(2), such wages are subject to such income tax withholding regardless of whether a withholding allowance certificate under section 3402(n) and this section has been furnished to the employer.

(c) *Liability for income tax.* For purposes of section 3402(n) and this section, an employee is not considered to incur liability for income tax imposed under subtitle A if the amount of such tax imposed is equal to or less than the total amount of credits against such tax which are allowable under chapter 1 of the Internal Revenue Code, other than those credits allowable under section 31 or 34. For purposes of this section, an employee who files a joint return under section 6013 is considered to incur liability for any tax shown on such return. An employee who is entitled to file a joint return under section 6013 shall not certify that the employee anticipates that he or she will incur no liability for income tax imposed by subtitle A for the employee's current taxable year if such statement would not be true in the event that the employee files a joint return for such year, unless the employee filed a separate return for the preceding taxable year and anticipates that the employee will file a separate return for the current taxable year.

(d) *Rules about withholding allowance certificates.* For rules relating to invalid withholding allowance certificates, see §31.3402(f)(2)-1(h), and for rules relating to disregarding certain withholding allowance certificates on which an employee claims a complete exemption from withholding, see §31.3402(f)(2)-1(i).

(e) *Examples.* The following examples illustrate this section:

(1) *Example 1. A.* an unmarried, calendar-year basis taxpayer, files an income tax return for 2020 on April 10, 2021, showing that A had adjusted gross income of \$5,000 and is not liable for any income tax for 2020. A had \$180 of income tax withheld during 2020. A anticipates that A's gross income for 2021 will be approximately the same amount, and that A will not incur income tax liability for that year. On April 20, 2021, A commences employment and furnishes the employer a withholding allowance certificate certifying that A incurred no liability for income tax imposed under subtitle A for 2020, and that A anticipates that A

will incur no liability for income tax imposed under subtitle A for 2021. A's employer shall not deduct and withhold on payments of wages made to A on or after April 20, 2021. Under §31.3402(f)(4)-1(b), unless A furnishes a new withholding allowance certificate including the certifications described in paragraph (a) of this section to the employer, the employer is required to deduct and withhold upon payments of wages to A made after February 15, 2022.

(2) *Example 2.* Assume the facts are the same as in paragraph (e)(1) of this section (Example 1) except that A had been employed by the employer prior to April 20, 2021, and had furnished the employer a withholding allowance certificate prior to furnishing the withholding allowance certificate including the certifications described in paragraph (a) of this section on April 20, 2021. Under §31.3402(f)(3)-1(b), the employer would be required to give effect to the new withholding allowance certificate no later than the beginning of the first payroll period ending (or the first payment of wages made without regard to a payroll period) on or after May 20, 2021. However, under §31.3402(f)(3)-1(b), the employer could, if it chose, make the new withholding allowance certificate effective with respect to any payment of wages made on or after April 20, 2021, and before the effective date mandated by section 3402(f)(3)(B)(i) and §31.3402(f)(3)-1(b). Under §31.3402(f)(4)-1(b), unless A furnishes a new withholding allowance certificate including the certifications described in §31.3402(n)-1(a) to A's employer, the employer is required to deduct and withhold upon payments of wages to A made after February 15, 2022.

(3) *Example 3.* Assume the facts are the same as in paragraph (e)(1) of this section (Example 1) except that for 2020 A has taxable income of \$8,000, income tax liability of \$839, and income tax withheld of \$1,195. Although A received a refund of \$356 due to income tax withholding of \$1,195, A may not certify on A's withholding allowance certificate that A incurred no liability for income tax imposed by subtitle A for 2020.

(f) *Applicability date.* The provisions of this section apply on and after October 6, 2020. Taxpayers may choose to apply paragraphs (a)(2) and (3) this section on or after January 1, 2020 and before October 6, 2020. For rules that apply before October 6, 2020, see 26 CFR part 31, revised as of April 1, 2020.

Sunita Lough,
Deputy Commissioner for Services
and Enforcement

Approved: September 29, 2020.

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

(Filed by the Office of the Federal Register on October 05, 2020, 8:45 a.m., and published in the issue of the Federal Register for October 6, 2020, 85 FR 63019)

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.
FR.—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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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2019–27 through 2019–52 is in Internal Revenue Bulletin 2019–52, dated December 27, 2019.

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Internal Revenue Service

Washington, DC 20224

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INTERNAL REVENUE BULLETIN

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