HIGHLIGHTS OF THIS ISSUE

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

ADMINISTRATIVE

REG-127391-16, page 1214.
This notice of proposed rulemaking modernizes regulations regarding the sale of a taxpayer’s property that the IRS seizes by levy. The proposed amendments would allow the IRS to maximize sale proceeds for the benefit of the taxpayer whose property the IRS has seized and the public fisc and would affect all sales of property the IRS seizes by levy.

EXEMPT ORGANIZATIONS

T.D.9981, page 1174.
These final regulations under section 509(a)(3) address the requirements for section 501(c)(3) organizations to qualify as public charities when they are operated, supervised or controlled by one or more supported organizations (Type I Supporting Organizations) and when they are operated in connection with one or more supported organizations (Type III Supporting Organizations). These final regulations provide rules for qualifying as functionally integrated and non-functionally integrated Type III Supporting Organizations. These final regulations also provide rules for the prohibition on certain contributions to Type I and Type III supporting organizations.

INCOME TAX

REG-117614-14, page 1193.
Treasury Regulation §1.367(b)-10 requires corporations that acquire parent stock or securities in exchange for property in connection with certain triangular reorganizations to make adjustments that have the effect of a distribution of property. The proposed regulations set forth additional rules that apply to a subsequent inbound non-recognition transaction in cases where those adjustments are not made.

SPECIAL ANNOUNCEMENT

Notice 2023-71, page 1191.
This notice grants relief under § 7508A of the Internal Revenue Code to taxpayers affected by the October 7, 2023 terrorist attacks in the State of Israel. The notice postpones deadlines for certain time-sensitive taxpayer and government acts for affected taxpayers for a full year, until October 7, 2024. The covered area receiving relief under this notice includes the State of Israel, the West Bank and Gaza. The notice also identifies categories of affected taxpayers and provides a non-exhaustive list of the acts postponed.
The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.
Part I
26 CFR 1.509(a)-4: Supporting Organizations

T.D. 9981

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 53

Requirements for Type I and Type III Supporting Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance on the prohibition on certain gifts or contributions to Type I and Type III supporting organizations from persons who control a supported organization and on certain other requirements for Type III supporting organizations. The regulations reflect changes to the law made by the Pension Protection Act of 2006. The regulations affect certain Type I and Type III supporting organizations and their supported organizations.

DATES: Effective date: These regulations are effective on October 16, 2023. Applicability date: For dates of applicability, see §1.509(a)-4(f).

FOR FURTHER INFORMATION CONTACT: Michael Gruccio at (202) 317-4541 or Don Spellmann at (202) 317-4086.

SUPPLEMENTARY INFORMATION:

Background

I. Overview

This document amends the Income Tax Regulations (26 CFR part 1) by adding final regulations under section 509(a) of the Internal Revenue Code (Code). These final regulations amend §1.509(a)-4 to provide guidance on amendments to the Code enacted by section 1241 of the Pension Protection Act of 2006 (PPA), Public Law 109-280, 120 Stat. 780 (August 17, 2006).

An organization described in section 501(c)(3) of the Code is classified as either a private foundation or a public charity. To be classified as a public charity, an organization must be described in section 509(a)(1), (2), or (3). Organizations described in section 509(a)(3) are known as “supporting organizations.” Supporting organizations achieve their public charity status by providing support to one or more organizations described in section 509(a)(1) or (2), which, in this context, are referred to as “supported organizations.” To be described in section 509(a)(3), an organization must satisfy (1) an organizational test, (2) an operational test, (3) a relationship test, and (4) a disqualified person control test. The organizational and operational tests require that a supporting organization be organized, and at all times thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more supported organizations. The relationship test requires a supporting organization to establish one of three types of relationships with one or more supported organizations. A supporting organization that is operated, supervised, or controlled by one or more supported organizations is known as a “Type I” supporting organization. The relationship of a Type I supporting organization with its supported organization(s) is comparable to that of a corporate parent-subsidiary relationship. A supporting organization that is supervised or controlled in connection with one or more supported organizations is known as a “Type II” supporting organization. The relationship of a Type II supporting organization with its supported organization(s) involves common supervision or control by the persons supervising or controlling both the supporting organization and the supported organization(s). A supporting organization that is operated in connection with one or more supported organizations is known as a “Type III” supporting organization and is discussed further in the remainder of this preamble.

Finally, the disqualified person control test requires that a supporting organization not be controlled directly or indirectly by certain disqualified persons.

Sections 1241 through 1243 of the PPA revised the requirements for supporting organizations. These final regulations under §1.509(a)-4 address section 1241’s five changes to the requirements an organization must satisfy to qualify as a Type III supporting organization.

The PPA made the following five changes to the requirements an organization must satisfy to qualify as a Type III supporting organization:

(1) Section 1241(c) of the PPA removed the ability of a charitable trust to rely on the special rule under §1.509(a)-4(i)(2)(iii) as then in effect, which allowed a trust to satisfy the attentiveness requirement of the integral part test for non-functionally integrated Type III supporting organizations if the supported organization was a beneficiary of the trust and state law allowed the beneficiary to enforce the trust and compel an accounting of the trust.

(2) Section 1241(d) of the PPA directed the Secretary of the Treasury or her delegate (Secretary) to promulgate regulations under section 509 that establish a new distribution requirement for Type III supporting organizations that are not “functionally integrated” (a non-functionally integrated (NFI) Type III supporting organization) to ensure that a “significant amount” is paid to supported organizations; for this purpose, the term “functionally integrated” means a Type III supporting organization that is not required under regulations to make payments to supported organizations, because the supporting organization engages in activities that relate to performing the functions of, or carrying out the purposes of, its supported organization(s); and

(3) Section 1241(b) of the PPA required a Type III supporting organization to provide annually to each of its supported organizations the information required by the Department of the Treasury (Treasury Department) and the IRS (referred to in §1.509(a)-4(i)(2) as the notification...
requirement) to ensure that the supporting organization is responsive to the needs or demands of its supported organization(s);

(4) Section 1241(b) of the PPA also prohibited a Type III supporting organization from accepting any gift or contribution from a person who, alone or together with certain related persons, directly or indirectly controls the governing body of a supported organization of the Type I or Type III supporting organization.

III. Prior Rulemaking

On August 2, 2007, the Treasury Department and the IRS published in the Federal Register (72 FR 42335) an advanced notice of proposed rulemaking (ANPRM) (REG-155929-06) in response to the PPA. The ANPRM described proposed rules to implement the changes made by the PPA to the Type III supporting organization requirements and solicited comments regarding those proposed rules.

On September 24, 2009, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-155929-06) in the Federal Register (74 FR 48672) proposing regulations regarding certain requirements to qualify as a Type III supporting organization under the PPA (2009 proposed regulations). The 2009 proposed regulations set forth those proposed requirements in §1.509(a)-4(i).

On December 28, 2012, the Treasury Department and the IRS published a Treasury Decision (TD 9605) in the Federal Register (77 FR 76382) containing final and temporary regulations under §1.509(a)-4 regarding the requirements to qualify as a Type III supporting organization (2012 TD). Also on December 28, 2012, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-155929-06) in the Federal Register (77 FR 76426) containing proposed regulations that incorporated the text of the temporary regulations in the 2012 TD by cross-reference. The temporary regulations in the 2012 TD made significant changes to the distribution requirement for NFI Type III supporting organizations. The 2012 TD adopted other aspects of the 2009 proposed regulations with some changes in response to comments and provided transition relief for Type III supporting organizations in existence on December 28, 2012, that met and continued to meet the test under former §1.509(a)-4(i)(3)(ii), known as the “but for” test, as in effect prior to December 28, 2012, treating them as functionally integrated until the first day of their second taxable year beginning after December 28, 2012. Upon expiration of this relief period, the 2012 TD requires these organizations to meet the same rules as all other supporting organizations to be considered functionally integrated. The preamble to the 2012 TD also identified issues for possible future rulemaking and requested comments.

On January 6, 2014, the Treasury Department and the IRS published Notice 2014-4, 2014-2 I.R.B. 274, to provide additional transition relief for any Type III supporting organization (1) supporting at least one supported organization that is a governmental entity to which the supporting organization is responsive (within the meaning of §1.509(a)-4(i)(3)) and (2) engaging in activities for or on behalf of the governmental supported organization that perform the functions of, or carry out the purposes of, the governmental supported organization and that, but for the involvement of the supporting organization, would normally be engaged in by the governmental supported organization itself. Notice 2014-4 stated that such an organization will be treated as a functionally integrated Type III supporting organization until the earlier of the date final regulations under §1.509(a)-4(i)(4)(iv) are published in the Federal Register or the first day of the organization’s third taxable year beginning after December 31, 2013.

On December 23, 2015, the Treasury Department and the IRS published a Treasury Decision (TD 9746) in the Federal Register (80 FR 79684) containing final regulations under §1.509(a)-4(i) regarding the distribution requirement for NFI Type III supporting organizations, finalizing the rule in the 2012 proposed and temporary regulations with very minor changes (2015 final regulations).

The preamble to the 2015 final regulations indicated that additional proposed regulations would be forthcoming to provide additional guidance for Type III supporting organizations, including specific rules under §1.509(a)-4(i)(4)(iv) for Type III supporting organizations that support governmental supported organizations; the 2012 TD had reserved §1.509(a)-4(i)(4)(iv). In addition, the preamble to the 2015 final regulations indicated that supporting organizations that support a governmental supported organization could continue to rely on Notice 2014-4 until the date of publication of the new proposed regulations.

On February 19, 2016, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-118867-10) in the Federal Register (81 FR 8446) containing proposed regulations under §1.509(a)-4(f) and (i) regarding the prohibition on certain contributions to Type I and Type III supporting organizations and the requirements for Type III supporting organizations (2016 proposed regulations). The 2016 proposed regulations addressed issues identified in the preamble to the 2012 TD as well as the comments (six in total) on the 2012 TD and Notice 2014-4.

The Treasury Department and the IRS received six comments in response to the 2016 proposed regulations. The comments are available for public inspection at https://www.regulations.gov or upon request. No public hearing was requested. After considering the comments received, the Treasury Department and the IRS adopt the 2016 proposed regulations in these final regulations with certain revisions described in the Summary of Comments and Explanation of Revisions.

Summary of Comments and Explanation of Revisions

I. Overview

This Summary of Comments and Explanation of Revisions addresses the comments that the Treasury Department and the IRS received in response to the 2016 proposed regulations and describes the revisions adopted in these final regulations. As described in this Summary of Comments and Explanation of
Revisions, these final regulations define the term “control” for purposes of section 509(f)(2), which prohibits a Type I or Type III supporting organization from accepting any gift or contribution from anyone who controls the governing body of the supported organization(s). These final regulations also set forth additional rules and requirements for Type III supporting organizations, including (1) additional requirements to meet the responsiveness test for all Type III supporting organizations; (2) additional rules regarding the qualification of an organization as a functionally integrated Type III supporting organization under §1.509(a)-4(i)(4), including specific rules for supporting organizations that support governmental supported organizations; and (3) additional rules regarding the required annual distributions under §1.509(a)-4(i)(5) by an NFI Type III supporting organization.

II. Contributions from Controlling Donors – Meaning of Control

Section 509(f)(2) and §1.509(a)-4(f)(5) prohibit Type I and Type III supporting organizations from accepting any gift or contribution from any person (other than an organization described in section 509(a)(1), (2), or (4)) who, alone or together with certain related persons (as described in §1.509(a)-4(f)(5)(ii)(B) or (C)), directly or indirectly controls the governing body of a supported organization of the Type I or Type III supporting organization, or from persons related to a person possessing such control. Section 509(f)(2) does not define “directly or indirectly controls.” The 2012 TD reserved §1.509(a)-4(f)(5)(ii), titled “Meaning of control,” for future proposed regulations.

The 2016 proposed regulations proposed defining “control” consistently with the definition of control in §1.509(a)-4(j), which relates to control by disqualified persons for purposes of the disqualified person control test in section 509(a)(3)(C) and §1.509(a)-4(a)(4). In general, under the 2016 proposed regulations, the governing body of a supported organization is considered “controlled” by a person if that person, alone or by aggregating his or her votes or positions of authority with certain related persons described in §1.509(a)-4(f)(5)(i)(B) or (C), may require the governing body of the supported organization to perform any act that significantly affects its operations or may prevent the governing body of the supported organization from performing any such act.

These final regulations adopt the definition of “control” proposed in the 2016 proposed regulations with minor changes to add clarity. These final regulations make clear that control exists if one or more persons described in §1.509(a)-4(f)(5)(i)(A), (B), or (C) hold 50 percent or more of the total voting power of the governing body or have the right to exercise veto power over the actions of the governing body. These final regulations also incorporate language from §1.509(a)-4(j)(1) to make clear that even if persons do not have control by virtue of having 50 percent or more of the voting power or a veto power, all pertinent facts and circumstances will be taken into consideration in determining whether such persons do in fact directly or indirectly control the governing body of a supported organization.

One commenter stated that if a parent supporting organization controls a supported organization, section 509(f)(2) would prohibit Type I and Type III supporting organizations of that controlled supported organization from accepting any gift or contribution from the parent supporting organization. To allow these contributions, the commenter recommended excluding from the definition of control the control a parent supporting organization exercises over its supported organizations.

Section 509(f)(2) only excepts gifts or contributions from organizations described in section 509(a)(1), (2), and (4). Congress did not provide an exception for section 509(a)(3) organizations. For this reason, the commenter’s recommendation is not consistent with section 509(f)(2), and these final regulations do not adopt it.

III. Type III Supporting Organization Relationship Test

Section 1.509(a)-4(i)(1) provides that, for each taxable year, a Type III supporting organization must satisfy (i) a notification requirement, (ii) a responsiveness test, and (iii) an integral part test provided in the regulations. The 2016 proposed regulations proposed additional rules regarding each of these requirements. These final regulations adopt the 2016 proposed rules with the modifications described in this part III.

A. Notification Requirement

Section 509(f)(1)(A) provides that an organization will not be considered a Type III supporting organization unless the organization provides to each supported organization, for each taxable year, such information as the Secretary may require to ensure that the organization is responsive to the needs or demands of the supported organizations. To satisfy this notification requirement, §1.509(a)-4(i)(2) requires a Type III supporting organization to provide to each of its supported organizations for each taxable year: (1) A written notice addressed to a principal officer of the supported organization describing the type and amount of all of the support it provided to the supported organization during the supporting organization’s preceding taxable year; (2) a copy of the supporting organization’s most recently filed Form 990, Return of Organization Exempt from Income Tax, or other annual information return required to be filed under section 6033; and (3) a copy of the supporting organization’s governing documents, including any amendments (unless previously provided and not subsequently amended). The 2016 proposed regulations proposed clarifying that for NFI Type III supporting organizations the description of support in the written notice must include all of the distributions described in §1.509(a)-4(i)(6) to the supported organization. These final regulations adopt this clarification.

Section 1.509(a)-4(i)(2)(iii) requires that the notification be transmitted by the last day of the fifth calendar month following the close of “that taxable year.” Due to the lack of clarity regarding the reference to “that taxable year,” the 2016 proposed regulations proposed amending §1.509(a)-4(i)(2) to clarify that a supporting organization must deliver the required documents to each of its...
supported organizations by the last day of the fifth month of the supporting organization’s taxable year after the taxable year in which it provided the support it is reporting. The preamble to the 2016 proposed regulations stated that the proposed change is intended to reduce confusion but does not substantively change the due date or the content of the required notification. The preamble also stated that the date of delivery is determined by applying the general principles of section 7502. The final regulations adopt this proposed amendment without change.

One commenter requested clarification that the annual written notice may summarize all the programs and services a supporting organization performs for its supported organization. The Treasury Department and the IRS agree that a supporting organization may summarize its activities directly furthering the exempt purpose of the supported organization as long as that summary provides sufficient notice to the supported organization on the character of the activity and its related costs. The report must include a brief narrative description of the support provided and sufficient financial detail for the recipient to identify the types and amounts of support being reported.

B. Responsiveness Test

Section 1.509(a)-4(i)(3)(i) provides that a supporting organization meets the responsiveness test if it is “responsive to the needs or demands of a supported organization.” To meet this responsiveness test, an organization must satisfy two elements—the “relationship requirement” and the “significant voice requirement.” Under the relationship requirement, described in §1.509(a)-4(i)(3)(ii), the officers, directors, or trustees of the organization must have one of three specified relationships with the officers, directors, or trustees (and in some cases the members) of the supported organization. Under the significant voice requirement, described in §1.509(a)-4(i)(3)(iii), the officers, directors, or trustees of the supported organization, by reason of their relationships described in §1.509(a)-4(i)(3)(ii), must have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making grants, and the selection of grant recipients by the supporting organization, and in otherwise directing the use of the income or assets of the supporting organization.

The preamble to the 2012 TD stated that, in determining the appropriate distribution amount for NFI Type III supporting organizations, the Treasury Department and the IRS considered the required relationship between a supporting organization and its supported organizations, and that the Treasury Department and the IRS intended to issue proposed regulations in the future that would amend the responsiveness test by requiring a Type III supporting organization to be responsive to all of its supported organizations.

In response to this proposal in the preamble to the 2012 TD, one commenter stated that a supporting organization should not be required to be responsive to all of its supported organizations because the resulting administrative burden would effectively limit the total number of organizations a supporting organization could support. The commenter suggested alternatives under which a supporting organization would be responsive to only a subset of its supported organizations that would vary from year to year.

As stated in the preamble to the 2016 proposed regulations, the distinguishing characteristic of Type III supporting organizations, and the basis for their public charity classification, is that they are responsive to and significantly involved in the operations of their publicly supported organizations. See §1.509(a)-4(f)(4). Unless a Type III supporting organization is responsive to each of its supported organizations, the supported organizations cannot exercise the requisite level of oversight of and engagement with the supporting organization. Limiting the responsiveness requirement to fewer than all of the supported organizations may result in the necessary oversight and accountability being present for less than all of a supporting organization’s operations. Consistent with this view, the 2016 proposed regulations proposed revising §1.509(a)-4(i)(3)(i) to require a supporting organization to be responsive to the needs and demands of each of its supported organizations to meet the responsiveness test.

In addition, to illustrate how concerns about potential administrative burdens may be addressed consistent with the revised responsiveness test, the 2016 proposed regulations proposed a new Example 3 in §1.509(a)-4(i)(3)(iv) to demonstrate one way in which a Type III supporting organization that supports multiple organizations may satisfy the responsiveness test in a manner that can be cost-effective. The Example shows that a supporting organization can meet the relationship requirement in §1.509(a)-4(i)(3)(ii) in different ways with respect to each of its supported organizations. The Example also shows how a supporting organization can organize and hold regular meetings, provide information, and encourage communication to help ensure that its supported organizations have a significant voice in the operations of the supporting organization.

As noted in the preamble to the 2016 proposed regulations, another commenter in response to the preamble to the 2012 TD requested additional guidance regarding the ability of trusts to satisfy the significant voice requirement of the responsiveness test. The new Example 3 in the 2016 proposed regulations provides further illustration of how Type III supporting organizations, including charitable trusts, might satisfy the significant voice requirement of the responsiveness test. The Treasury Department and the IRS note that although the examples in the regulations relating to the responsiveness test may involve a Type III supporting organization that is organized as either a corporation or a trust, the applicable law and relevant regulatory provisions, as modified by the final regulations, are applicable to all Type III supporting organizations in the same manner, whether they are organized as corporations or trusts.

As the preamble to the 2016 proposed regulations stated, the Treasury Department and the IRS anticipate that Type III supporting organizations may be able to demonstrate that they satisfy the responsiveness test in a variety of ways, and that the determination will be based on all the facts and circumstances.

As a result of the proposed changes to the responsiveness test, the 2016 proposed regulations also include conforming
changes to examples and other regulatory provisions, specifically, removing references to "supported organizations to which the supporting organization is responsive" since the supporting organization is to be responsive to each supported organization.

Two commenters to the 2016 proposed regulations address the responsiveness test, agreeing with the proposed amendments to §1.509(a)-4(i)(3)(i) and the new example in §1.509(a)-4(i)(3)(iv). Thus, these final regulations adopt these proposed amendments without change.

C. Integral Part Test – Functionally Integrated Type III Supporting Organizations

Section 1.509(a)-4(i)(1)(iii) provides that, for each taxable year, a Type III supporting organization must satisfy the integral part test. The integral part test under §1.509(a)-4(i)(1)(iii) is satisfied by maintaining significant involvement in the operations of one or more supported organizations and providing support on which the supported organizations are dependent. To satisfy this test, a Type III supporting organization must meet the requirements either for a functionally integrated Type III supporting organization or for an NFI Type III supporting organization, as set forth in §1.509(a)-4(i)(4) or (5), respectively.

One commenter to the 2016 proposed regulations stated that the cross reference in §1.509(a)-4(d)(4)(i)(C) to the integral part test should be corrected to conform to the amendments made by the 2012 TD. The final regulations adopt this recommendation and revise §1.509(a)-4(d)(4)(i)(C) to reference the requirements of the integral part test set forth in §1.509(a)-4(i)(1)(iii).

A Type III supporting organization is functionally integrated under §1.509(a)-4(i)(4) if it (1) engages in activities substantially all of which directly or indirectly, by the governing body, members of the governing body, or officers (acting in their official capacities) of the supporting organization.

As the 2009 proposed regulations noted, the classification of a parent organization as functionally integrated was intended to “apply to supporting organizations that oversee or facilitate the operation of an integrated system, such as hospital systems.” To more fully accomplish this objective, the 2016 proposed regulations proposed a revision to §1.509(a)-4(i)(4)(iii) clarifying that for a supporting organization to qualify as the parent of each of its supported organizations, the supporting organization and its supported organizations must be part of an integrated system (such as a hospital system), and the supporting organization must engage in activities typical of the parent of an integrated system. The 2016 proposed regulations stated that examples of these activities include (but are not limited to) coordinating the activities of the supported organizations and engaging in overall planning, policy development, budgeting, and resource allocation for the supported organizations.

One commenter requested that the final regulations provide additional examples of integrated systems, such as private schools and universities, continuing care retirement communities, and residential rehabilitation facilities. The parenthetical in the 2016 proposed regulations—such as a hospital system—is stated as only one example and is not exclusive. This section of the regulations applies to any type of integrated system of which the parent organization and its supported organizations are a part. The test is whether the structure is that of an integrated system and whether the requirements of §1.509(a)-4(i)(4)(iii) are satisfied, not whether the system is in a particular industry. The Treasury Department and the IRS conclude that it is unnecessary to add other examples of industries that may have integrated systems; doing so at this time may indicate that any industries not specifically mentioned in the final regulations are excluded. Accordingly, the final regulations do not adopt the commenter’s request to provide additional examples. Nevertheless, in response to the comment and to make clear that a hospital system is
just one example of an integrated system, the final regulations revise the parenthetical in the 2016 proposed regulations to read as follows: (such as, for example, a hospital system).

The commenter also recommended including additional examples of activities that are typical of a parent of an integrated system and suggested that the examples might include financial planning and forecasting, legal services, human resources, information management, billing and collection services, marketing, and community outreach and education. The Treasury Department and the IRS note that the list of activities in the 2016 proposed regulations was only illustrative of how a parent directs the overall policies, programs, and activities of the supported organizations within the integrated system and was not exclusive. Thus, the absence of any particular activity, such as financial planning, from this list is not determinative. The final regulations clarify that a parent of an integrated system of supported organizations must direct the overall policies, programs, and activities of the supported organizations (such as, for example, coordinating the activities of the supported organizations and engaging in overall planning, policy development, budgeting, and resource allocation). The Treasury Department and the IRS note that a parent of an integrated system may also perform system-wide administrative services, such as the examples provided by the commenter, in conjunction with directing the overall policies, programs, and activities of the supported organizations. For clarity, these final regulations omit the defined term “activities typical of a parent” in proposed §1.509(a)-4(i)(4)(iii). The 2016 proposed regulations proposed to retain the requirement in §1.509(a)-4(i)(4)(iii) that the governing body, members of the governing body, or officers of a parent supporting organization must appoint or elect a majority of the officers, directors, or trustees of the supported organization. The preamble to the 2016 proposed regulations stated that the use of the phrase “appointed or elected, directly or indirectly” means the supporting organization could qualify as a parent of a second-tier (or lower) subsidiary. Thus, for example, if the directors of supporting organization A appoint a majority of the directors of supported organization B, which in turn appoints a majority of the directors of supported organization C, the directors of supporting organization A will be treated as appointing the majority of the directors of both supported organization B and supported organization C. One commenter agreed with this interpretation and requested that it be addressed in the final regulations. These final regulations adopt this recommendation.

As stated in the preamble to the 2016 proposed regulations, the Treasury Department and the IRS interpret the existing requirement under §1.509(a)-4(i)(4)(iii) that the parent organization have the power to appoint or elect a majority of the officers, directors, or trustees of each supported organization to include the requirement that the parent organization also have the power to remove and replace such officers, directors, or trustees, or otherwise have an ongoing power to appoint or elect with reasonable frequency. One commenter requested that language reflecting this interpretation be specifically added to §1.509(a)-4(i)(4)(iii). The final regulations adopt this commenter’s recommendation.

3. Supporting a Governmental Supported Organization

The 2012 TD reserved §1.509(a)-4(i)(4)(iv) for future guidance on how a Type III supporting organization can qualify as functionally integrated by supporting a governmental entity. As interim guidance, Notice 2014-4 provided that a Type III supporting organization will be treated as functionally integrated if it (i) supports a supported organization that is a governmental entity to which the supporting organization is responsive; and (ii) engages in activities for or on behalf of that governmental supported organization that perform the functions of, or carry out the purposes of, that governmental supported organization and that, but for the involvement of the supporting organization, would normally be engaged in by the governmental supported organization itself. This interim guidance was subsequently extended by the 2015 final regulations. The 2016 proposed regulations proposed new rules under which a Type III supporting organization would qualify as functionally integrated by supporting governmental supported organizations. These final regulations adopt the proposed §1.509(a)-4(i)(4)(iv), with the modifications discussed in the following paragraphs.

The 2016 proposed regulations proposed that a supporting organization that only supports governmental supported organizations would be considered functionally integrated if a substantial part of its total activities directly further the exempt purposes of its governmental supported organizations and, if the supporting organization supports more than one governmental supported organization, all of its governmental supported organizations either: (1) Operate within the same geographic region (defined as a city, county, or metropolitan area); or (2) work in close coordination or collaboration with each other to conduct a service, program, or activity that the supporting organization supports. The 2016 proposed regulations proposed defining a governmental supported organization as a governmental unit described in section 170(c)(1), or an organization described in section 170(c)(2) and (b)(1)(A) (other than in clauses (vii) and (viii)) that is an instrumentality of one or more governmental units described in section 170(c)(1). To satisfy the close coordination or collaboration requirement, the proposed regulations proposed requiring a supporting organization to maintain on file a letter from each of the governmental supported organizations (or a joint letter from all of them) describing their coordination or collaboration efforts with respect to the particular service, program, or activity. The 2016 proposed regulations proposed an exception to this rule for certain pre-existing organizations that support no more than one non-governmental supported organization along with one or more governmental supported organizations, as well as a transition rule for pre-existing organizations that continue to meet the requirements of Notice 2014-4.

Two commenters recommended that Type III functionally integrated supporting organizations should not be limited to only supporting governmental supported organizations. One commenter proposed that a supporting organization which supports both governmental and non-governmental
supported organizations should qualify as functionally integrated if the supporting organization (i) conducts activities that perform the functions of or carry out the purposes of its governmental supported organization(s), (ii) its non-governmental supported organizations operate in the same geographic region or work in close coordination or collaboration with the governmental supported organization(s), and (iii) substantially all of the supporting organization’s activities directly further the exempt purposes of its governmental supported organization(s).

The other commenter recommended replacing the requirement that all supported organizations be governmental supported organizations with a new requirement that substantially all the activities of the supporting organization either (i) directly further the purposes of the governmental supported organizations, or (ii) consist of grantmaking, fundraising, or investing for governmental supported organizations that meet either the same geographic region or close coordination and collaboration requirements in the 2016 proposed regulations.

A third commenter requested that, when a supporting organization supports more than one governmental supported organization, the governmental supported organizations should only be required to work in close coordination or collaboration. The commenter requested deleting the requirement that the governmental supported organizations conduct a service, program, or activity that the supporting organization supports.

The 2016 proposed regulations proposed allowing certain Type III supporting organizations that support governmental supported organizations to be classified as functionally integrated on the basis that the involvement of the governmental supported organizations in the supporting organization’s activities would minimize the potential for abuse. As stated in the preamble to the 2016 proposed regulations, requiring close cooperation and collaboration on a common service, program, or activity that the supporting organization supports helps ensure that the governmental supported organizations will provide sufficient input to and oversight of the supporting organization. Moreover, the coordination and collaboration between these supported organizations would be greatly diminished if they engaged in different services, programs, or activities. Furthermore, governmental input and oversight would be diluted if the definition of functionally integrated were expanded to permit these supporting organizations to support and be responsive to non-governmental supported organizations as well. Additionally, for the reasons discussed later in this preamble, the Treasury Department and the IRS utilize the substantial part test for supporting governmental supported organizations (instead of the substantially all test) but specifically exclude grant making and other financial activities from the definition of activities that directly further the exempt purposes of the governmental supported organizations. Accordingly, these final regulations do not adopt these recommendations. For clarity, these final regulations omit the defined term “geographic region” contained in proposed §1.509(a)-4(i)(4)(iv)(C).

As noted previously in this preamble, the 2016 proposed regulations proposed that, for simplicity and administrability, the term “governmental supported organization” be defined using an existing Code definition of governmental unit. Three commenters stated their support for this definition. Thus, the final regulations adopt the definition in the 2016 proposed regulations with the clarification described in the following paragraph.

The preamble to the 2016 proposed regulations noted that, because a governmental unit described in section 170(c)(1) includes all of the agencies, departments, and divisions of that governmental unit, all such agencies, departments, and divisions will be treated as one governmental supported organization for purposes of §1.509(a)-4(i)(4)(iv). One commenter stated its support for this position and requested that it be specifically written into the regulations. These final regulations adopt this commenter’s recommendation. The final regulations specifically state that a governmental unit includes all of its agencies, departments, and divisions, and that they will be treated as one governmental supported organization for these purposes.

One commenter on the 2016 proposed regulations requested that an instrumentality of a governmental supported organization and the governmental supported organization with respect to which it is an instrumentality should be treated as one governmental supported organization. The final regulations do not adopt this recommendation because, unlike an agency, department, or division of a governmental unit, an instrumentality described in §1.509(a)-4(i)(4)(iv)(B)(2) is a separate legal entity.

The 2016 proposed regulations also proposed that supporting organizations that support only governmental supported organizations may qualify as functionally integrated only if a “substantial part” of their activities directly furthers the exempt purposes of their governmental supported organization(s). The 2016 proposed regulations proposed using the same definition of “directly further” contained in §1.509(a)-4(i)(4)(ii)(C), the integral part test for functionally integrated Type III supporting organizations, as promulgated in the 2012 TD. This definition provides that fundraising, making grants, and investing and managing non-exempt-use assets are not activities that directly further the exempt purposes of the supported organization.

One commenter recommended that fundraising, making grants, and investing and managing non-exempt-use assets should be considered activities that directly further the exempt purposes of a governmental supported organization. The Treasury Department and the IRS determined that a Type III supporting organization should qualify as functionally integrated only if the supporting organization itself conducts activities that perform the functions of or carry out the purposes of its supported organization (as distinguished from providing financial support for the activities carried out by the supported organization). As the 2012 TD stated, fundraising, making grants, and investing and managing non-exempt-use assets relate to producing and distributing income to finance the charitable activities directly carried out by the supported organization. The 2016 proposed regulations did not adopt comments seeking to apply a different definition of “directly further” to supporting organizations that support governmental supported organizations. These final regulations do not adopt the
commenter’s proposal because using a different definition of “directly further” for governmental supported organizations would undermine a fundamental distinction that §1.509(a)-4(i)(4) makes between functionally integrated and NFI Type III supporting organizations, i.e., directly conducting charitable activities versus financing charitable activities. The Treasury Department and the IRS also note the complexity and administrative difficulty of applying different definitions of “directly further” under the integral part test. These final regulations adopt the requirement in the 2016 proposed regulations that a substantial part of the supporting organization’s total activities must directly further the exempt purposes of its governmental supported organizations.

These final regulations also add a new example to clarify that a supporting organization can meet this requirement and still make grants to one of its governmental supported organizations as a substantial part of its activities. As the preamble to the 2016 proposed regulations stated, the “substantial part” test in §1.509(a)-4(i)(4)(iv) allows these supporting organizations to conduct more fundraising and other financial activities, if certain requirements are met, than is permitted under the “substantially all” test of §1.509(a)-4(i)(4)(ii) that applies generally to be a functionally integrated Type III supporting organization. One commenter requested confirmation concerning the identity of these certain requirements that must be met. Under §1.509(a)-4(i)(4) as promulgated by the 2012 TD and amplified by these final regulations in providing the rules for supporting governmental supported organizations, the organization must meet the annual notification requirement in §1.509(a)-4(i)(2) and the responsiveness test in §1.509(a)-4(i)(3), in addition to the specific requirements in §1.509(a)-4(i)(4)(iv), in order to be a functionally integrated Type III supporting organization by virtue of supporting governmental supported organizations.

One commenter recommended providing a clear definition of what constitutes a substantial part of a supporting organization’s total activities for purposes of meeting §1.509(a)-4(i)(4)(iv). Another commenter recommended not adopting a bright line rule to measure the quantity of activities that equal a substantial part, but requested a statement in the final regulations that all pertinent facts and circumstances will be taken into account. This commenter also requested more examples of activities that directly further the exempt purpose of the governmental supported organization and clarification in the regulations to require that a substantial part of a supporting organization’s activities directly further the exempt purposes of “at least one” (as opposed to all) of its governmental supported organizations when the governmental supported organizations share a common geographic region.

In response to these comments, the final regulations revise proposed §1.509(a)-4(i)(4)(iv) to provide that, in determining whether a substantial part of a supporting organization’s total activities directly further the exempt purposes of its governmental supported organization(s), all pertinent facts and circumstances will be taken into consideration. This approach is consistent with the approach in §1.509(a)-4(i)(4)(ii)(B), which determines “substantially all” for the general test of being functionally integrated by considering all pertinent facts and circumstances. The final regulations also revise proposed §1.509(a)-4(i)(4)(iv)(A) and add a new example in §1.509(a)-4(i)(4)(v) to make clear that a supporting organization that supports more than one governmental supported organization as described in §1.509(a)-4(i)(4)(iv)(A) satisfies the substantial part test if a substantial part of its activities directly further the exempt purpose of at least one of its governmental supported organizations.

One commenter stated that proposed §1.509(a)-4(i)(4)(iv)(A)(I)(ii), which uses the phrase “close coordination or collaboration,” should be made consistent with proposed §1.509(a)-4(i)(4)(iv)(D), which uses the phrase “close cooperation or coordination.” The final regulations adopt this recommendation and make the provisions consistent by changing the phrasing in §1.509(a)-4(i)(4)(iv)(C) of the final regulations to “close coordination or collaboration.” No substantive change is intended by this revision.

The 2016 proposed regulations proposed an exception to the general rule for supporting organizations that support governmental supported organizations. The exception would treat a Type III supporting organization in existence on or before February 19, 2016 (the date of the issuance of the 2016 proposed regulations), as functionally integrated if: (1) It supports one or more governmental supported organizations and no more than one supported organization that is not a governmental supported organization; (2) it designated each of its supported organizations as provided in §1.509(a)-4(d)(4) on or before February 19, 2016; and (3) a substantial part of its total activities directly further the exempt purposes of its governmental supported organization(s).

One commenter stated that the proposed exception would allow it and similar organizations currently to qualify as functionally integrated. The final regulations adopt the proposed exception without change.

The 2016 proposed regulations also proposed further extending the transition relief provided in Notice 2014-4 and extended in the preamble to the 2015 final regulations. Under the 2016 proposed regulations, a Type III supporting organization in existence on or before February 19, 2016, that met and continues to meet the requirements of Notice 2014-4 would be treated as functionally integrated until the earlier of the first day of the organization’s first taxable year beginning after the date final regulations are published under §1.509(a)-4(i)(4)(iv) or the first day of the organization’s second taxable year beginning after February 19, 2016. The Treasury Department and the IRS did not receive any comments about the transition rule or any requests to extend the transition period in the 2016 proposed regulations, which now has expired. The Treasury Department and the IRS therefore conclude supporting organizations have had sufficient time to adjust to the new rules and further transition relief is not necessary. Accordingly, these final regulations do not provide a further extension of the transition relief proposed in the 2016 proposed regulations.

D. Integral Part Test – Non-Functionally Integrated Type III Supporting Organizations

Section 1.509(a)-4(i)(5) provides that a supporting organization meets the
integral part test to be an NFI Type III supporting organization if it satisfies the distribution requirement of §1.509(a)-4(i)(5)(ii) and the attentiveness requirement of §1.509(a)-4(i)(5)(iii), or the pre-November 2, 1970, trust requirements of §1.509(a)-4(i)(9). Section 1.509(a)-4(i)(5)(ii) provides that, with respect to each taxable year, a supporting organization must distribute to or for the use of one or more supported organizations an amount equaling or exceeding its “distributable amount.” Section 1.509(a)-4(i)(6) provides the amount of a distribution made to a supported organization is the amount of cash or the fair market value of the property distributed.

The 2016 proposed regulations proposed revising §1.509(a)-4(i)(5)(ii) to state that a supporting organization must make distributions as described in §1.509(a)-4(i)(6) in a total amount equaling or exceeding the supporting organization’s distributable amount to satisfy the distribution requirement, and proposed revising §1.509(a)-4(i)(6) to describe in detail what distributions count toward satisfying the distribution requirement. These final regulations adopt these proposed revisions, explained as follows, without change.

1. No Reduction of Distributable Amount for Taxes Subtitle A Imposes

Section 1.509(a)-4(i)(5)(ii)(B) provides that the distributable amount is equal to the greater of 85 percent of an organization’s adjusted net income for the immediately preceding taxable year (as determined by applying the principles of section 4942(f) of the Code and §53.4942(a)-2(d)) or its minimum asset amount for the immediately preceding taxable year, reduced by the amount of taxes imposed on the supporting organization under subtitle A of the Code (subtitle A) during the immediately preceding taxable year.

Because the taxes under subtitle A are imposed on a supporting organization’s unrelated business taxable income (pursuant to section 511 of the Code) and the activity that produces the unrelated business taxable income does not further the supported organization’s exempt purposes, the preamble to the 2016 proposed regulations stated that these taxes should not be treated as the functional equivalent of an amount distributed to a supported organization. The 2016 proposed regulations, therefore, proposed removing the provision in §1.509(a)-4(i)(5)(ii)(B) that reduces the distributable amount by the amount of taxes subtitle A imposed on a supporting organization during the immediately preceding taxable year.

One commenter stated that the distributable amount should be reduced by the amount of taxes imposed on the supporting organization’s unrelated business income, as section 4942(d) provides for private foundations. In advocating to retain the reduction in the distributable amount, the commenter suggested that only the supporting organization’s after-tax income from unrelated business activities should be considered available for distribution to its supported organizations.

A supporting organization’s adjusted net income under §1.509(a)-4(i)(5)(ii)(B) includes gross income from all sources, including investment income that is not subject to tax under section 511. The 2012 TD and the 2015 final regulations, therefore, stated it was necessary to revise the distribution requirement to ensure that NFI Type III supporting organizations distribute significant amounts to their supported organizations, as Congress directed in the PPA. As stated in the 2015 final regulations, the 85 percent of adjusted net income test makes it more likely that supported organizations will timely benefit from higher returns received by their supported organizations. Reducing the distributable amount by any taxes on the income would be counter to this objective.

The Treasury Department and the IRS further note that section 4942(d) only applies to private non-operating foundations. As the preamble to the 2012 TD recounted, a number of commenters to the 2009 proposed regulations stated that NFI Type III supporting organizations should not be subject to the higher payout for private non-operating foundations because they are distinguishable from them. These commenters stated that NFI Type III supporting organizations are more similar to private operating foundations and medical research organizations and therefore should be subject to their lower payout requirements. The 2012 TD and the 2015 final regulations adopted this recommendation, providing lower payout requirements for NFI Type III supporting organizations than for private non-operating foundations. Private operating foundations and medical research organizations are not able to reduce their payout requirements by the taxes imposed by subtitle A. See §1.170A-9(d)(2)(v) (B); §53.4942(b)-1(a)(1)(ii). The Treasury Department and the IRS conclude for the foregoing reasons that it would be inconsistent to apply a different rule to NFI Type III supporting organizations. Therefore, these final regulations adopt the 2016 proposed revision to §1.509(a)-4(i)(5)(ii)(B) without change.

2. Distributions that Count toward Distribution Requirement

Section 1.509(a)-4(i)(6) provides details on the distributions by a supporting organization that count toward satisfying the distribution requirement imposed in §1.509(a)-4(i)(5)(ii). The regulations provide that distributions include but are not limited to: (1) Any amount paid to a supported organization to accomplish the supported organization’s exempt purposes; (2) any amount paid by the supporting organization to perform an activity that directly furthers the exempt purposes of the supported organization within the meaning of §1.509(a)-4(i)(4)(ii), but only to the extent such amount exceeds any income derived by the supporting organization from the activity; (3) any reasonable and necessary administrative expenses paid to accomplish the exempt purposes of the supported organization(s), which do not include expenses incurred in the production of investment income; (4) any amount paid to acquire an exempt-use asset described in §1.509(a)-4(i)(8)(ii); and (5) any amount set aside for a specific project that accomplishes the exempt purposes of a supported organization to which the supporting organization is responsive.

The list in §1.509(a)-4(i)(6) is not exhaustive and other distributions may count towards the distribution requirement. As stated in the preamble to the 2016 proposed regulations, the use of a non-exclusive list creates uncertainty for supporting organizations and the IRS about what counts toward the distribution
requirement. Therefore, the 2016 proposed regulations proposed revising and clarifying the list in §1.509(a)-4(i)(6) of what counts toward the distribution requirement and making it an exclusive list.

a. Reasonable and necessary administrative expenses

Under §1.509(a)-4(i)(6), reasonable and necessary administrative expenses paid to accomplish the exempt purposes of supported organizations, but not expenses incurred in the production of investment income, count toward the distribution requirement. For example, if a supporting organization conducts exempt activities that are for the benefit of, perform the functions of, or carry out the purposes of its supported organization(s) and also conducts nonexempt activities (such as investment activities or unrelated business activities), then the supporting organization’s administrative expenses (such as salaries, rent, utilities and other overhead expenses) must be allocated between the exempt and nonexempt activities on a reasonable and consistently-applied basis. The supporting organization’s administrative expenses attributable to the exempt activities are treated as distributions to its supported organization(s) if such expenses are reasonable and necessary. Conversely, the administrative expenses and operating costs attributable to the nonexempt activities are not treated as distributions to the supported organization(s). The 2016 proposed regulations proposed retaining this provision, with additional guidance regarding fundraising expenses.

b. Fundraising expenses

Section 1.509(a)-4(i)(6) does not specifically address whether fundraising expenses count toward the distribution requirement. The 2016 proposed regulations addressed the issue, specifying that reasonable and necessary administrative expenses paid to accomplish the exempt purposes of a supported organization generally do not include fundraising expenses the supporting organization incurs. For example, when a supporting organization conducts a fundraising event for its supported organization(s) and distributes the proceeds of the event, net of its fundraising expenses, to its supported organization(s), only the amount that the supporting organization actually distributes to its supported organization(s) counts towards the distribution requirement. Thus, under the 2016 proposed regulations, the supporting organization’s fundraising expenses do not count towards the distribution requirement.

If a supporting organization conducts a fundraising event at which the supporting organization instructs donors to make contributions directly to the supported organization, the 2016 proposed regulations proposed that those contributions would not count as a distribution from the supporting organization to its supported organization. However, in this situation the supporting organization could count towards the distribution requirement the reasonable and necessary expenses it incurs to solicit the contributions the donors pay directly to its supported organization: (1) to the extent that the amount of these solicitation expenses does not exceed the amount of contributions the supported organization actually receives; and (2) if the supporting organization can substantiate (as discussed later in this preamble) that those contributions were received as a result of the supporting organization’s solicitation activities. The 2016 proposed regulations proposed this rule to provide consistency with the treatment of contributions that supporting organizations receive directly and then distribute to their supported organizations (net of the supporting organization’s solicitation expenses).

While commenters were generally supportive of the proposal to count as distributions the fundraising expenses incurred to solicit contributions directly to the supported organization, one commenter recommended deleting the requirement that contributions be received directly by the supported organization for the fundraising expenses to count. Alternatively, the commenter requested this special rule for fundraising expenses also apply if the contributions were received directly by an agent of the supported organization.

Another commenter proposed that contributions the supporting organization received directly from the fundraising solicitation as a matter of convenience should be treated as contributions the supported organization received directly if the supporting organization is contractually obligated to remit the contributions to the supported organization and the supporting organization actually distributes the contributions to the supported organization within a reasonable time period. The commenter also proposed that the supporting organization be allowed to count its fundraising solicitation expenses in the year it incurred them so long as the supported organization received the corresponding contributions within a reasonable time period following the end of that year.

In response to these comments, these final regulations adopt the proposed rules with certain modifications and clarifications. These final regulations provide that expenses the supporting organization incurs to solicit contributions count towards the distribution requirement when the resulting contributions are received directly by a supported organization, but only to the extent that the supporting organization’s expenses for each solicitation do not exceed the amount of contributions a supported organization actually receives, and only if the supporting organization substantiates that those contributions were received as a result of the supporting organization’s solicitation activities. This limitation is applied on a solicitation-by-solicitation basis; the supporting organization may not aggregate its expenses, or the contributions a supported organization receives, from more than one solicitation to determine the amount of solicitation expenses that count towards its distribution requirement. The Treasury Department and the IRS intend that contributions are received directly by the supported organization when donors make their checks, credit card or other payments payable to the supported organization. The Treasury Department and the IRS also intend that when a supporting organization receives checks or processes credit card or other transactions that are payable to its supported organization, the supporting organization may count as distributions the expenses it incurs for soliciting those checks or credit card or other payments, but only up to the amount of contributions received directly by or paid directly to the supported organization and substantiated by the supported
organization. Thus, for purposes of meeting its distribution requirement, the supporting organization may not count as distributions from the supporting organization to the supported organization the amount of the check and credit card or other contributions the donors make payable to the supported organization. Contributions made payable to the supporting organization that are transferred to the supported organization, however, may be counted as distributions from the supporting organization to the supported organization at the time that the funds are given by the supporting organization to the supported organization. These final regulations do not adopt a rule permitting payments that are first deposited with the supporting organization to count as contributions received directly by the supported organization (for purposes of permitting additional solicitation expenses related to those contributions to count as distributions). Preventing the supporting organization from counting those amounts twice toward satisfying the supporting organization’s annual distribution requirements and accounting for those funds in the supporting organization’s account would be administratively difficult.

c. Joint fundraising expenses

One commenter also requested guidance on how to allocate contributions when the supporting organization and the supported organization share the costs of a solicitation event. The Treasury Department and the IRS do not intend for the rule for fundraising expenses to apply with respect to a solicitation event if the supported organization incurs more than de minimis costs related to the same solicitation event. Section 1.509(a)-4(i)(6)(i) permits supporting organizations to count any amount they pay to their supported organization as a distribution for purposes of satisfying the annual distribution requirement described in §1.509(a)-4(i)(5)(ii). A supporting organization can, therefore, share the costs of a fundraiser by distributing to the supported organization an amount equal to the supporting organization’s share of the joint fundraising expenses. Section 1.509(a)-4(i)(6)(i) would permit the supporting organization to count this payment as a distribution for purposes of §1.509(a)-4(i)(5)(ii), negating the need for a special rule in proposed §1.509(a)-4(i)(6)(iii)(B). The Treasury Department and the IRS note that it would be very difficult to determine and substantiate what portion of the contributions a supported organization receives are attributable to the supporting organization’s expenditures. Thus, expanding the rule to cover joint solicitation efforts as the commenter suggests would increase the compliance burden on supporting organizations and supported organizations and would be difficult for the IRS to administer. These final regulations, therefore, do not adopt this recommendation.

d. Taxable year to which fundraising expenses are attributable

One commenter requested a clarification that contributions made to a supported organization in response to a supporting organization’s end-of-the-year fundraiser that the supported organization does not receive until the following year may be used to determine the portion of reasonable and necessary fundraising expenses the supporting organization may treat as a distribution for the year in which the fundraiser occurred. This commenter recommended a 90-day window in the second year for counting such contributions. These final regulations clarify that, for purposes of applying the limitation on the supporting organization’s solicitation expenses for each taxable year that count toward its distribution requirement, any contributions the supported organization receives directly from donors that are attributable to a solicitation the supporting organization conducted in a particular taxable year includes any contributions the supported organization receives and substantiates in writing on or before the due date (without regard to extensions) of the supporting organization’s Form 990 for the year in which it conducted the solicitation.

For example, assume a supporting organization makes a solicitation on December 15, 2024. The supported organization receives contributions from donors of $1x on December 26, 2024, and $2x on March 15, 2025, that are attributable to the solicitation made on December 15, 2024. The supported organization substantiates the total contributions of $3x in writing prior to May 15, 2025 (the due date without extensions of the supporting organization’s Form 990 for 2024). The written substantiation indicates that these contributions were attributable to the December 15, 2024 solicitation. Under §1.509(a)-4(i)(6)(iii)(B), the supporting organization may treat up to $3x of any reasonable and necessary expenses it incurred for the December 15, 2024 solicitation toward its distribution requirement.

A supporting organization may not take into account the same contributions in computing the fundraising expense limitation in more than one year or with respect to more than one solicitation. Thus, in the preceding example, the $2x contribution the supported organization received on March 15, 2025, may only be used by the supporting organization to determine its fundraising expense limitation for the December 15, 2024, solicitation. The supporting organization may not use the $2x again to determine its 2025 fundraising expense limitation.

e. Written substantiation from supported organization

The 2016 proposed regulations proposed requiring a supporting organization to obtain written substantiation from the supported organization of the amount of contributions the supported organization actually receives as a result of each of the supporting organization’s solicitations. One commenter requested that the permitted written substantiation include an email from the supported organization that the supporting organization maintains in its electronic records. These final regulations adopt this recommendation, stating that the written substantiation may be provided by electronic media.

Another commenter requested that a supported organization be allowed to aggregate into a single annual written report the substantiation of all the contributions it received from the supporting organization’s fundraising activities. The commenter also requested that the supported organization should only be responsible for reporting the amount of the contributions it received and not be responsible for calculating the supporting organization’s fundraising activities.
These final regulations clarify that the supporting organization may substantiate the contributions provided to the supported organization by a single annual statement in writing from the supported organization, provided that the amount of contributions, if any, received by the supported organization as a result of each solicitation is separately identified. To satisfy §1.509(a)-4(i)(6)(iii)(B), the written substantiation must be postmarked or electronically transmitted to the supporting organization no later than the due date (without regard to extensions) of the supporting organization’s Form 990 for the year of the solicitation. In addition, written substantiation relied on by the supporting organization (whether provided in one or multiple reports) must separately state the amount of contributions, if any, received directly by the supported organization allocable to each solicitation made by the supporting organization that is covered in the report. The supporting organization is responsible for determining its solicitation expenses. The written substantiation the supporting organization is required to receive from the supported organization need only provide information relevant to the amount of contributions the supported organization received; it does not need to address the supporting organization’s expenses.

f. Program-related investments not taken into account

Finally, one commenter requested that program-related investments (PRIs) count toward the distribution requirement. The preamble to the 2016 proposed regulations stated that, for purposes of meeting the integral part test, PRIs are not treated as distributions to the supported organizations. As the preamble to the 2016 proposed regulations stated, the Treasury Department and the IRS recognize that private foundations may use PRIs in a variety of ways to accomplish their exempt purposes and that PRIs thus are treated as qualifying distributions under section 4942. However, because supporting organizations must be operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of their supported organizations, they differ from private foundations. Furthermore, other provisions relating to the distribution requirement, such as the availability of set-asides and the potential for carry-forwards of excess distributions, provide significant flexibility for supporting organizations to meet the current and future needs of their supported organizations. For these reasons, these final regulations do not adopt this recommendation.

IV. Technical Corrections

This Treasury Decision conforms the paragraphs throughout §1.509(a)-4 to the Code of Federal Regulations by making non-substantive changes, including capitalizing letters of fourth level paragraphs. This Treasury Decision also modifies §53.4947-1 to correct certain cross-references to §1.509(a)-4.

V. Applicability Date

These final regulations are applicable to taxable years beginning on or after October 16, 2023. Taxpayers may choose to apply these final regulations to taxable years beginning on or after February 19, 2016, and before October 16, 2023, so long as the taxpayer applies the provisions of these final regulations in their entirety and in a consistent manner.

Special Analyses

I. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6(b) of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

The collection of information in these regulations is in §1.509(a)-4(i)(4)(iv)(C) (written record of close coordination or collaboration by certain governmental supported organizations) and §1.509(a)-4(i)(6)(iii)(B) (written record of contributions received by certain supported organizations). Requiring a supporting organization to collect (1) written records of its governmental supported organizations’ close coordination or collaboration with each other and (2) written records of the contributions its supported organizations directly received from donors in response to solicitations by the supporting organization helps the IRS determine whether the supporting organization is a functionally integrated or non-functionally integrated Type III supporting organization. The record keepers are certain Type III supporting organizations.

Estimated number of recordkeepers: 6,089.

Estimated average annual burden hours per recordkeeper: 2 hours.

Estimated total annual recordkeeping burden: 12,178 hours.

Estimated frequency of collection of such information: Annual.

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

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

III. Regulatory Flexibility Act

In connection with the requirements of the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these final regulations will not impact a substantial number of small entities.

Based on IRS Statistics of Income data for 2019, there are 1,365,744 active non-profit charitable organizations recognized by the IRS under section 501(c)(3), of
which only 6,089 organizations self-identified as Type III supporting organizations. The universe of organizations that would be affected by §1.509(a)-4(i)(4)(iv)(C) and §1.509(a)-4(i)(6)(iii)(B) is a subset of all Type III supporting organizations, because those provisions apply either to organizations seeking to qualify as functionally integrated based on support of two or more governmental supported organizations or to non-functionally integrated organizations that solicit contributions that are received directly by a supported organization (rather than by the supporting organization). Thus, the number of organizations that will be affected by the collection of information under §1.509(a)-4(i)(4)(iv)(C) and (i)(6)(iii)(B) will not be substantial. Moreover, the time to complete the recordkeeping requirements is expected to be no more than 2 hours for each organization, thus the regulations will not have a significant economic impact. The requirements under §1.509(a)-4(i)(4)(iv)(C) and (i)(6)(iii)(B), therefore, will not have a significant economic impact.

Pursuant to section 7805(f) of the Code, this regulation was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business and 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. The regulations do 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 (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. The regulations do not have federalism implications, impose substantial direct compliance costs on State and local governments, or preempts State law within the meaning of the Executive order.

VI. Congressional Review Act

Pursuant to the Congressional Review Act (5 U.S.C. 801 et seq.), the Office of Management and Budget’s Office of Information and Regulatory Affairs designated this rule as not a “major rule,” as defined by 5 U.S.C. 804(2).

Statement of Availability of IRS Documents


Drafting Information

The principal authors of these regulations are Jonathan Carter and Don Spellmann, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, the Treasury Department and the IRS amend 26 CFR parts 1 and 53 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows: Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.509(a)-4 is amended by:

1. In paragraph (d)(2)(i) introductory text, removing “subsection (iv) of this subparagraph” and “paragraph (1) of this paragraph” and adding “paragraph (d)(2)(iv) of this section” and “paragraph (d)(1) of this section” in their places, respectively.

2. Redesignating paragraphs (d)(2)(i) (a) and (b) as paragraphs (d)(2)(i)(A) and (B), respectively.

3. In newly redesignated paragraph (d)(2)(i)(B)(1), removing “(a) of this subdivision” and adding “paragraph (d)(2)(i)(A) of this section” in its place.

4. In newly redesignated paragraph (d)(2)(i)(B)(2), removing “(i)(a) or this subparagraph” and adding “paragraph (d)(2)(i)(A) of this section or this paragraph (d)(2)(i)(B)(2)” in its place.

5. In paragraph (d)(2)(ii), removing “subsection (i)(a) or this subparagraph”, “subparagraph (1) of this paragraph” and “subparagraphs (3)(i), (ii), and (iii) and (4)(i) (a) and (b) of this paragraph” and adding “paragraph (d)(2)(i)(A) of this section”, “paragraph (d)(1) of this section”, and “paragraphs (d)(3)(i) through (iii) and (d)(4)(i)(A) and (B) of this section” in their places, respectively.

6. In paragraph (d)(2)(iii) introductory text, removing “paragraph” and adding “paragraph (d)(2)” in its place.

7. Designating Examples 1 and 2 of paragraph (d)(2)(iii) as paragraphs (d)(2)(iii)(A) and (B), respectively.

8. In paragraph (d)(2)(iv) introductory text, removing “subparagraph (1) of this paragraph” and adding “paragraph (d)(1) of this section” in its place.

9. Redesignating paragraphs (d)(2)(iv) (a) and (b) as paragraphs (d)(2)(iv)(A) and (B), respectively.

10. In newly redesignated paragraph (d)(2)(iv)(A), removing “; and” and adding “; and” in its place.
11. In paragraph (d)(3) introductory text, removing “subparagraph (2)(i) (a) of this paragraph” and adding “paragraph (d) (2)(i)(A) of this section” in its place.

12. In paragraph (d)(4)(i) introductory text, removing “subparagraph (2)(iv) of this paragraph” and “this subparagraph” and adding “paragraph (d)(2)(iv) of this section” and “this paragraph (d)(4)” in their places, respectively.

13. Redesignating paragraphs (d)(4)(ii) (a) through (c) as paragraphs (d)(4)(i)(A) through (C), respectively.


15. In paragraph (d)(4)(ii), removing “subdivision (i)(b) of this subparagraph” and “subdivision (i)(b)” and adding “paragraph (d)(4)(i)(B) of this section” and “paragraph (d)(4)(i)(B)” in their places, respectively.

16. In paragraph (d)(4)(iii) introductory text, removing “subparagraph” and adding “paragraph (d)(4)” in its place.

17. Designating the Example in paragraph (d)(4)(iii) as paragraph (d)(4)(iii) (A) and adding reserved paragraph (d)(4) (iii)(B).

18. In paragraph (e)(3) introductory text, removing “paragraph” and adding “paragraph (e)” in its place.

19. Designating Examples 1 through 5 of paragraph (e)(3) as paragraphs (e)(3)(i) through (v), respectively.

20. Revising paragraph (f)(5)(i).

21. In paragraph (g)(2) introductory text, removing “paragraph” and adding “paragraph (g)” in its place.

22. Designating Examples 1 through 3 of paragraph (g)(2) as paragraphs (g)(2)(i) through (iii), respectively.

23. In newly redesignated paragraph (g)(2)(iii), removing “subparagraph (1(ii) of this paragraph” and adding “paragraph (g)(1)(ii) of this section” in its place.

24. In paragraph (h)(3) introductory text, removing “paragraph” and adding “paragraph (h)” in its place.

25. Designating Examples 1 through 3 of paragraph (h)(3) as paragraphs (h)(3)(i) through (iii), respectively.

26. Revising paragraphs (i)(2)(i) introductory text, (i)(2)(i)(A), (i)(2)(iii), and (i)(3)(i).

27. Designating Examples 1 and 2 of paragraph (i)(3)(iv) as paragraphs (i)(3) (iv)(A) and (B), respectively.


29. Revising paragraphs (i)(4)(ii)(A) (i), (i)(4)(ii)(B), and (i)(4)(iii) and (iv).

30. Designating Examples 1 through 5 of paragraph (i)(4)(v) as paragraphs (i)(4)(v)(A) through (E), respectively.


32. Revising paragraphs (i)(5)(ii)(A) and (B) and (i)(5)(iii)(A).

33. Designating Examples 1 through 4 of paragraph (i)(5)(iii)(D) as paragraphs (i)(5)(iii)(D)(I) through (IV), respectively.

34. Revising newly designated paragraph (i)(5)(iii)(D), the third sentence of paragraph (i)(6) introductory text, and paragraphs (i)(6)(i)(i) and (v) introductory text.

35. In paragraph (k)(2) introductory text, removing “paragraph” and adding “paragraph (k)” in its place.

36. Designating the Example in paragraph (k)(2) as paragraph (k)(2)(i) and adding reserved paragraph (k)(2)(ii).

37. Revising paragraph (l).

The revisions and additions read as follows:

§1.509(a)-4 Supporting organizations.

* * * * *

(i) * * *

(d) * * *

(4) * * *

(i) * * *

(C) Permit the supporting organization to vary the amount of its support between different designated organizations, so long as it meets the requirements of the integral part test set forth in paragraph (i)(1)(iii) of this section with respect to at least one beneficiary organization.

* * * * *

(f) * * *

(5) * * *

(ii) Meaning of control. For purposes of paragraph (f)(5)(i) of this section, the governing body of a supported organization will be considered controlled by a person described in paragraph (f)(5)(i) (A) of this section if that person, alone or by aggregating the person’s votes or positions of authority with persons described in paragraph (f)(5)(i)(B) or (C) of this section, may require the governing body of the supported organization to perform any act that significantly affects its operations or may prevent the governing body of the supported organization from performing any such act. The governing body of a supported organization will be considered to be controlled directly or indirectly by one or more persons described in paragraph (f)(5)(i)(A), (B), or (C) of this section if the voting power of such persons is 50 percent or more of the total voting power of such governing body or if one or more of such persons have the right to exercise veto power over the actions of the governing body of the supported organization. Thus, if the governing body of a supported organization is composed of five members, none of whom has a veto power over the actions of the supported organization, and no more than two members are at any time described in paragraph (f)(5)(i)(A), (B), or (C) of this section, such supported organization will not be considered to be controlled directly or indirectly by such persons by reason of this fact alone. However, all pertinent facts and circumstances will be taken into consideration in determining whether one or more persons do in fact directly or indirectly control the governing body of a supported organization.

* * * * *

Examples 1 through 5

Due date

October 30, 2023

1187

Bulletin No. 2023–44
transmitted by the last day of the fifth calendar month of the Reporting Year.

(3) * * *

(i) General rule. A supporting organization meets the responsiveness test only if it is responsive to the needs or demands of each of its supported organizations. Except as provided in paragraph (i)(3)(v) of this section, in order to meet this test, a supporting organization must satisfy the requirements of paragraphs (i)(3)(ii) and (iii) of this section with respect to each of its supported organizations.

(iv) * * *

(C) Example 3. Z is described in section 501(c)(3). Z’s organizational documents provide that it supports ten different organizations, each of which is described in section 509(a)(1). One of the directors of S (one of the supported organizations) is a voting member of Z’s board of directors and participates in Z’s regular board meetings. Officers of Z hold regularly scheduled face-to-face or telephonic meetings during the year, to which officers of all the supported organizations are invited. Z’s meetings with the supported organizations may be held jointly or separately. Prior to the meetings, Z makes available to the supported organizations (including by email) up-to-date information about its activities, including its assets and liabilities, receipts and distributions, and investment policies and returns. In the meetings, officers of each of the supported organizations have an opportunity to ask questions and discuss with officers of Z the projected needs of their organizations, as well as Z’s investment and grant making policies and practices. In addition to holding these meetings with the supported organizations, Z provides the contact information of one of its officers to each of the supported organizations and encourages them to contact that officer if they have questions, or if they wish to schedule additional meetings to discuss the projected needs of their organization and how Z should distribute its income and invest its assets. Z provides the information required under paragraph (ii)(2) of this section and a copy of its annual audited financial statements to the principal officers of the supported organizations. Z meets the relationship requirement of paragraph (i)(3)(ii)(B) or (C) of this section with respect to each of its supported organizations. Based on these facts, Z also satisfies the significant voice requirement of paragraph (i)(3)(iii) of this section, and therefore meets the responsiveness test of this paragraph (i)(3) with respect to each of its ten supported organizations.

(4) * * *

(ii) * * *

(A) * * *

(1) Directly further the exempt purposes of one or more supported organizations by performing the functions of, or carrying out the purposes of, such supported organization(s); and

(B) Meaning of substantially all. For purposes of paragraph (i)(4)(ii)(A) of this section, in determining whether substantially all of a supporting organization’s activities directly further the exempt purposes of one or more supported organization(s), all pertinent facts and circumstances will be taken into consideration.

(iii) Parent of supported organization(s)—(A) In general. For purposes of paragraph (i)(4)(i)(B) of this section, in order for a supporting organization to qualify as the parent of each of its supported organizations—

(1) The supporting organization and its supported organizations must be part of an integrated system (such as, for example, a hospital system);

(2) The supporting organization must direct the overall policies, programs, and activities of the supported organizations (such as, for example, coordinating the activities of the supported organizations and engaging in overall planning, policy development, budgeting, and resource allocation); and

(3) The supporting organization’s governing body, members of the governing body, or officers (acting in their official capacities) must appoint or elect, directly or indirectly, a majority of the officers, directors, or trustees of each supported organization and have the power to remove and replace such directors, officers, or trustees, or otherwise have an ongoing power to appoint or elect such directors, officers or trustees with reasonable frequency.

(B) Subsidiary organizations. A supporting organization may meet the requirements of paragraph (i)(4)(i)(A)(J) of this section with respect to a second-tier (or lower) subsidiary provided that the supporting organization, by control of its first-tier subsidiary, has the power to appoint or elect (as described in paragraph (i)(4)(ii)(A)(3) of this section) a majority of the officers, directors, or trustees of the lower-tier subsidiary. For example, if the board of directors of supporting organization A elects a majority of the directors of supported organization B, and the board of directors of B, in turn, elect, by a simple majority vote, a majority of the directors of supported organization C, the directors of supporting organization A will be treated as electing a majority of the directors of both supported organization B and supported organization C.

(iv) Supporting a governmental supported organization—(A) In general. A supporting organization satisfies the requirements of this paragraph (i)(4)(iv) if—

(1) The supporting organization only supports one or more governmental supported organizations;

(2) In any case in which the supporting organization supports more than one governmental supported organization, all of the governmental supported organizations either—

(i) Operate within the same city, county, or metropolitan area; or

(ii) Work in close coordination or collaboration with one another to conduct a service, program, or activity that the supporting organization supports; and

(3) A substantial part of the supporting organization’s total activities are activities that directly further, as defined by paragraph (i)(4)(ii)(C) of this section, the exempt purposes of at least one governmental supported organization.

(B) Governmental supported organization defined. For purposes of paragraph (i)(4)(iv)(A) of this section, the term governmental supported organization means a supported organization that is:

(1) A governmental unit described in section 170(c)(1), including all of its agencies, departments, and divisions (all of which will be treated as one governmental supported organization for purposes of this paragraph (i)(4)(iv)); or

(2) An organization described in section 170(c)(2) and (b)(1)(A) (other than in clauses (vii) and (viii)) that is an instrumentality of one or more governmental units described in section 170(c)(1).

(C) Close coordination or collaboration. To satisfy the close coordination or collaboration requirement of paragraph (i)(4)(iv)(A)(2) of this section, the supporting organization must maintain on file a letter from each of the governmental supported organizations (or a joint letter from all of them) describing their coordination or collaboration efforts with respect to the particular service, program, or activity.
(D) Substantial part. For purposes of paragraph (i)(4)(iv)(A)(3) of this section, in determining whether a substantial part of a supporting organization’s activities directly further the exempt purposes of one or more governmental supported organization(s), all pertinent facts and circumstances will be taken into consideration.

(E) Exception for organizations supporting a governmental supported organization on or before February 19, 2016. A Type III supporting organization in existence on or before February 19, 2016, will be treated as meeting the requirements of this paragraph (i)(4)(iv) if it met and continues to meet the following requirements:

(1) It supports one or more governmental supported organizations described in paragraph (i)(4)(iv)(B) of this section and does not support more than one supported organization that is not a governmental supported organization;

(2) Each of the supported organizations is designated by the supporting organization as provided in paragraph (d)(4) of this section on or before February 19, 2016; and

(3) A substantial part (as defined in paragraph (i)(4)(iv)(D) of this section) of the supporting organization’s total activities are activities that directly further (as defined by paragraph (i)(4)(ii)(C) of this section) the exempt purposes of its governmental supported organization(s).

(F) Transition rule for supporting organizations in existence on or before February 19, 2016. Until the first day of the organization’s second taxable year beginning after February 19, 2016, a Type III supporting organization in existence on or before February 19, 2016, will be treated as meeting the requirements of this paragraph (i)(4)(iv) if it continuously met the following requirements prior to the first day of the organization’s second taxable year beginning after February 19, 2016—

(1) It supported at least one supported organization that was a governmental entity to which the supporting organization was responsive within the meaning of paragraph (i)(3) of this section; and

(2) It engaged in activities for or on behalf of the governmental supported organization described in paragraph (i)(4)(iv)(E)(I) of this section that performed the functions of, or carried out the purposes of, that governmental supported organization and that, but for the involvement of the supporting organization, would normally have been engaged in by the governmental supported organization itself.

** * * * *

(4) Example 6. X, an organization described in section 501(c)(3), is organized and operated as a supporting organization to two organizations, City and Park. X meets the responsiveness test described in paragraph (i)(3) of this section with respect to both City and Park. City and Park are both governmental units described in section 170(c)(1). Park maintains a state park located within the same county as City. X does not support any other organizations. X supports Park by operating an information center for visitors to Park. The information center provides educational material and information sessions to visitors to Park. X’s activities related to operating the Park information center constitute a substantial part of X’s activities. X also makes grants directly to City to fund City’s other programs. X’s grant making activities constitute a substantial part of X’s activities. X meets the requirements of paragraph (i)(4)(iv)(A)(I) of this section because X only supports City and Park, both of which are governmental supported organizations described in paragraph (i)(4)(iv)(B) of this section. X meets the requirements of paragraph (i)(4)(iv)(A)(2) of this section because City and Park operate within the same county in accordance with paragraph (i)(4)(iv)(A)(2)(i) of this section. Finally, X meets the requirements of paragraph (i)(4)(iv)(A)(3) of this section because a substantial part of X’s activities directly further (within the meaning of paragraph (i)(4)(ii)(C) of this section) Park’s exempt purposes, even though X’s grants to City are also a substantial part of X’s activities. Based on these facts, X qualifies as functionally integrated under paragraph (i)(4)(iv) of this section.

** * * * *

(5) * * *

(ii) * * *

(A) Annual distribution. With respect to each taxable year, a supporting organization must make distributions described in paragraph (i)(6) of this section in a total amount equaling or exceeding the supporting organization’s distributable amount for the taxable year, as defined in paragraph (i)(5)(ii)(B) of this section, on or before the last day of the taxable year.

(B) Distributable amount. Except as provided in paragraphs (i)(5)(ii)(D) and (E) of this section, the distributable amount for a taxable year is an amount equal to the greater of 85 percent of the supporting organization’s adjusted net income (as determined by applying the principles of section 4942(f) and §53.4942(a)-2(d) of this chapter) for the taxable year immediately preceding the taxable year of the required distribution (immediately preceding taxable year) or its minimum asset amount (as defined in paragraph (i)(5)(ii)(C) of this section) for the immediately preceding taxable year.

** * * * *

(6) ** ** Distributions by the supporting organization that count toward the distribution requirement imposed in paragraph (i)(5)(ii) of this section are limited to—

(iii) Any reasonable and necessary—

(A) Administrative expenses paid to accomplish the exempt purposes of the supported organization, which do not include expenses incurred in the production of investment income or expenses incurred in the conduct of fundraising activities (except solicitation expenses described in paragraph (i)(6)(iii)(B) of this section); and

(B) Expenses incurred to solicit contributions that are received directly by a supported organization (rather than by the
supporting organization), but only to the extent the amount of the reasonable and necessary expenses the supporting organization incurs for each solicitation does not exceed the amount of contributions that are actually received by the supported organization directly from donors as a result of each such solicitation, as substantiated in a written report by the supporting organization to the supporting organization that is postmarked or electronically transmitted by the due date of the supporting organization’s Form 990 (or successor form) for the year of the solicitation(s) (without regard to extensions);

***(v) Any amount set aside for a specific project that accomplishes the exempt purposes of a supported organization, with such set-aside counting toward the distribution requirement for the taxable year in which the amount is set aside but not in the year in which it is actually paid, if at the time of the set-aside, the supporting organization—

***(l) Applicability dates. (1) Paragraphs (a)(6), (f)(5), and (i) of this section are applicable on December 28, 2012, except—

(i) Paragraphs (i)(4)(ii)(C), (i)(5)(ii)(C) and (D), (i)(6)(iv), (i)(7)(ii), and (i)(8) of this section are applicable on December 21, 2015; and

(ii) Paragraphs (d)(4)(i)(C), (f)(5)(ii), (i)(2)(i) and (ii), (i)(3)(i), (i)(3)(iv)(C) (Example 3), (i)(4)(ii)(A) (J), (i)(4)(ii)(B), (i)(4)(iii) and (iv), (i)(4)(v)(F) (Example 6), (i)(5)(ii)(A) and (B), (i)(5)(iii)(A), (i)(5)(iii)(D)(4) (Example 4), (i)(6) introductory text, and (i)(6)(iii) and (v) of this section are applicable to taxable years beginning on or after October 16, 2023.

(2) Taxpayers may choose to apply the paragraphs listed in paragraph (l)(1)(ii) of this section to taxable years beginning on or after February 19, 2016, and before October 16, 2023, provided the taxpayer applies the provisions listed in paragraph (l)(1)(ii) of this section in their entirety and in a consistent manner.

(3) See paragraphs (i)(5)(ii)(B) and (C) and (i)(8) of §1.509(a)-4T contained in 26 CFR part 1, revised as of April 1, 2015, for certain rules regarding non-functionally integrated Type III supporting organizations effective before December 21, 2015. See paragraphs (i)(5)(ii)(A) and (B) and (i)(5)(iii)(D) of §1.509(a)-4 contained in 26 CFR part 1, revised as of April 1, 2023, for certain rules regarding non-functionally integrated Type III supporting organizations effective before October 16, 2023.

**PART 53—FOUNDATION AND SIMILAR EXCISE TAXES**

Par. 3. The authority citation for part 53 continues to read in part as follows:

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

§53.4947-1 [Amended]

Par. 4. Section 53.4947-1 is amended in paragraph (b)(3) by removing the language “§§ 1.509(a)–4(d)(2)(iv)(a), and 1.509(a)–4(i)(1)(ii) and (iii)(c)” and “the regulations under section 507(b)(1)” and adding in their places “§ 1.509(a)-4(d)(2)(iv)(A) and (i)(1)(ii) of this chapter” and “the regulations in this part under section 507(b)(1)”, respectively.

Douglas W. O’Donnell,
Deputy Commissioner for Services and Enforcement.

Approved: August 20, 2023.

Lily L. Batchelder,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register October 13, 2023, 8:45 a.m., and published in the issue of the Federal Register for October 16, 2023, 88 FR 71287)
Part III

Relief for Taxpayers Affected by the Terroristic Action in the State of Israel

Notice 2023-71

SECTION I. PURPOSE

This notice provides relief under section 7508A of the Internal Revenue Code (Code) 1 for persons that the Secretary of the Treasury (Secretary) has determined to be affected by a terroristic or military action in the State of Israel beginning on October 7, 2023. The Department of the Treasury and the Internal Revenue Service (IRS) may provide additional relief in the future.

SECTION II. BACKGROUND

Section 7508A(a) provides the Secretary with authority to postpone the time (up to one year) for performing certain acts under the internal revenue laws for a taxpayer determined by the Secretary to be affected by a terroristic or military action as defined in section 692(c)(2). Section 692(c)(2) defines a terroristic action as “any terroristic activity which a preponderance of the evidence indicates was directed against the United States or any of its allies.”

Section 4.01(1) of Revenue Procedure 2004-26, 2004-1 C.B. 890, provides that prior to publishing a determination that an event outside the United States constitutes a terroristic action within the meaning of section 692(c)(2), the Secretary will ascertain whether the Department of State and the Department of Justice believe that a preponderance of the evidence indicates that the event resulted from terrorist activity directed against the United States or its allies. In accordance with the procedures described in Revenue Procedure 2004-26, the Secretary has determined that the terrorist attacks beginning on October 7, 2023, against the State of Israel (October 7, 2023 Terrorist Attacks) constitute terroristic action within the meaning of section 692(c)(2).

SECTION III. GRANT OF RELIEF

With respect to taxpayers described in section III.A of this notice (affected taxpayers), this notice postpones the due dates for the actions described in section III.B of this notice (postponed acts) until October 7, 2024.

A. Affected Taxpayers

Section 301.7508A-1(d)(1) describes several types of “affected taxpayers” eligible for relief under section 7508A. The Secretary has determined that the following types of taxpayers are affected taxpayers with respect to the October 7, 2023 Terrorist Attacks eligible for the relief provided in this notice:

- Any individual whose principal residence, and any business entity or sole proprietor whose principal place of business, is located in the State of Israel, the West Bank or Gaza (covered area);
- Any individual affiliated with a recognized government or philanthropic organization and who is assisting in the covered area, such as a relief worker;
- Any individual, business entity or sole proprietor, or estate or trust whose tax return preparer or records necessary to meet a deadline for postponed acts are located in the covered area;
- Any spouse of an affected taxpayer, solely with regard to a joint return of two married individuals; and
- Any individual visiting the covered area who was killed, injured, or taken hostage as a result of the October 7, 2023 Terrorist Attacks.

The IRS automatically identifies taxpayers whose principal residence or principal place of business is located in the covered area based on previously filed returns and applies relief. Affected taxpayers whose principal residence or principal place of business is not located in the covered area should call the IRS disaster hotline at (866) 562-5227 to request relief. Alternatively, international callers may call (267) 941-1000.

B. Postponement of Due Dates with Respect to Certain Taxpayer Acts

Affected taxpayers have until October 7, 2024, to file tax returns, make tax payments, and perform certain time-sensitive acts listed in § 301.7508A-1(c)(1) and Rev. Proc. 2018-58, 2018-50 I.R.B. 990 (December 10, 2018), that are due to be performed on or after October 7, 2023, and before October 7, 2024. Any taxpayer acts that are due to be performed on or after October 7, 2023, and before October 7, 2024, are postponed until October 7, 2024. These acts include, but are not limited to:

- Filing any return of income tax, estate tax, gift tax, generation-skipping transfer tax, excise tax (other than firearms tax), harbor maintenance tax, or employment tax;
- Paying any income tax, estate tax, gift tax, generation-skipping transfer tax, excise tax (other than firearms tax), harbor maintenance tax, or employment tax, or any installment of those taxes;
- Making contributions to a qualified retirement plan;
- Filing a petition with the Tax Court;
- Filing a claim for credit or refund of any tax; and
- Bringing suit upon a claim for credit or refund of any tax.

This is not an exhaustive list. For further information, see § 301.7508A-1(c)(1) and Rev. Proc. 2018-58.

C. Postponement of Due Dates with Respect to Certain Government Acts

This notice also provides the IRS with additional time to perform certain time-sensitive actions with respect to

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1 Unless otherwise specified, all “Section” or “§” references are to sections of the Code or the Procedure and Administration Regulations (26 CFR part 301).
affected taxpayers. Any government acts described in § 301.7508A-1(c)(2) that are due to be performed on or after October 7, 2023, and before October 7, 2024, are postponed until October 7, 2024. These acts include:

- Assessing any tax;
- Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;
- Collecting by the IRS, by levy or otherwise, of the amount of any liability in respect of any tax; and
- Bringing suit by the United States, or any officer on its behalf, in respect of any liability in respect of any tax; and allowing a credit or refund of any tax.

SECTION IV. DRAFTING INFORMATION

The principal author of this notice is the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, you may call (202) 317-3400 (not a toll-free call).
Part IV

Notice of Proposed Rulemaking

Guidance under Section 367(b) Related to Certain Triangular Reorganizations and Inbound Nonrecognition Transactions

REG-117614-14

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes regulations announced and described in Notice 2014-32 and Notice 2016-73, with modifications. The proposed regulations relate to the treatment of property used to acquire parent stock or securities in connection with certain triangular reorganizations involving one or more foreign corporations; the consequences to persons that receive parent stock or securities pursuant to such reorganizations; and the treatment of certain subsequent inbound nonrecognition transactions following such reorganizations and certain other transactions. The proposed regulations affect corporations engaged in certain triangular reorganizations involving one or more foreign corporations, certain shareholders of foreign corporations acquired in such reorganizations, and foreign corporations that participate in certain inbound nonrecognition transactions.

DATES: Written or electronic comments and requests for a public hearing must be received by December 5, 2023. Requests for a public hearing must be submitted as prescribed in the “Comments and Request for Public Hearing” section.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-117614-14) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comments submitted electronically and on paper, to its public docket. Send paper submissions to: CC:PA:LPD:PR (REG-117614-14), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brady Plastaras at (202) 317-6937; concerning submission of comments, requests for a public hearing, and access to a public hearing, Vivian Hayes at (202) 317-5306 (not toll-free numbers) or by email at publichearings@irs.gov (preferred).

SUPPLEMENTARY INFORMATION:

Background

On May 19, 2011, the Treasury Department and the IRS published final regulations (TD 9526) in the Federal Register (76 FR 28890) under section 367(b) that relate to the treatment of property used to acquire parent stock or securities in certain triangular reorganizations involving one or more foreign corporations (the Final Regulations). On April 25, 2014, the Treasury Department and the IRS issued Notice 2014-32 (2014-20 IRB 1006), which identified transactions designed to exploit certain aspects of the Final Regulations and announced that regulations would be issued under section 367 to address these transactions. On December 2, 2016, the Treasury Department and the IRS issued Notice 2016-73 (2016-52 IRB 908), which identified other transactions designed to exploit the Final Regulations, as modified by the rules announced in Notice 2014-32, and announced that additional regulations would be issued under section 367. The Treasury Department and the IRS believe that the transactions described in each notice raise significant policy concerns.

This document sets forth the regulations described in Notice 2014-32 and Notice 2016-73, modified as discussed in this preamble. In response to a request for comments in Notice 2016-73, one comment was received and is discussed in this preamble. No comments were received on Notice 2014-32.

Explanation of Provisions; Summary of Comment in Response to Notice 2016-73

I. Overview

A. Section 367—in general

Section 367(a)(1) provides that in connection with any exchange described in section 332, 351, 354, 356, or 361, a United States person transfers property to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation. Under section 367(a)(5), the Secretary has broad authority to exempt transactions from the application of section 367(a)(1) in order to carry out the purposes of section 367(a).

Section 367(b)(1) provides that, in the case of any exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes. Section 367(b)(2) provides that the regulations prescribed pursuant to section 367(b)(1) shall include (but shall not be limited to) regulations dealing with the sale or exchange of stock or securities in a foreign corporation by a United States person, including regulations providing the circumstances under which gain is recognized currently, amounts are included in gross income as a dividend, or both; and the extent to which adjustments are made
to earnings and profits, the basis of stock or securities, and the basis of assets.

B. Policies of section 367(b)

Section 367(b) was enacted to help ensure that international tax considerations are adequately addressed when the provisions in chapter 1, subchapter C, of subtitle A of the Internal Revenue Code (the Code) apply to an exchange involving a foreign corporation. Thus, the regulations under section 367(b) require that adjustments or inclusions be made to prevent the material distortions of income that can occur when the subchapter C provisions apply to an exchange involving a foreign corporation.

The legislative history to section 367(b) describes Congress’s particular concern with the need “to protect against tax avoidance . . . upon the repatriation of previously untaxed foreign earnings” and its intent to grant the Treasury Department broad authority to promulgate regulations to prevent the avoidance of Federal income taxes. H.R. Rep. No. 94-658, at 241 (1975). Moreover, Congress specifically identified “transfers constituting a repatriation of foreign earnings” as a type of transfer to be covered by such regulations. Id. at 245. The Final Regulations were promulgated in part to address these concerns. More specifically, one of the purposes of the Final Regulations is to require adjustments to address the avoidance of U.S. tax, including the repatriation of foreign earnings without being subject to U.S. tax, through the separation of earnings and profits of a corporation from property distributed by such corporation in connection with certain triangular reorganizations.

C. Effect of the Tax Cuts and Jobs Act

In 2017, Congress passed the Tax Cuts and Jobs Act (TCJA) (Pub. L. No. 115-97), which added and amended a number of international tax provisions. One effect of these new provisions, and in particular sections 951A and 965, was to increase the amount of foreign earnings or income subject to immediate U.S. taxation. Section 965 imposed a one-time transition tax on certain earnings and profits of foreign corporations, and section 951A subjects certain income of a controlled foreign corporation (CFC) (as defined in section 957(a)) to current U.S. taxation in the hands of the CFC’s United States shareholders (as defined in section 951(b)). The TCJA also generally retained the existing anti-deferral rules in subpart F of the Code (sections 951 through 965, as amended), under which, for example, a CFC’s passive income, subject to certain exceptions, is similarly subject to current U.S. taxation. The combined effect of sections 951, 951A, and 965 is that an increased amount of foreign earnings and profits will have been subject to U.S. tax regardless of whether the earnings and profits are in fact repatriated. Under section 959, such previously taxed earnings and profits (PTEP) are not again subject to U.S. tax upon their repatriation.

The TCJA also added section 245A to the Code, under which certain United States shareholders of a specified 10-percent owned foreign corporation (SFC) (as defined in section 245A(b)(1)) generally are entitled to a 100-percent dividends received deduction with respect to dividends received from the SFC. As a result of the TCJA, an increased amount of earnings and profits of foreign corporations are thus not taxable when distributed—either because the earnings and profits constitute PTEP or give rise to dividends (including deemed dividends under section 367(b)) that are eligible for the section 245A dividends received deduction.

Although as a result of the TCJA a lesser amount of earnings and profits of foreign corporations may give rise to taxable dividends when distributed, the Final Regulations remain necessary to carry out the policies of section 367(b). The adjustments required by the Final Regulations are intended to ensure that property transfers that are in substance distributions are treated as such, and thus give rise to income, capital gain, or a reduction in basis under section 301(c). Furthermore, incentives to avoid treating property transfers as distributions remain. For example, a taxpayer may seek to avoid distribution treatment because the distribution would not qualify for the section 245A dividends received deduction due to the application of the hybrid dividend rules under section 245A(e) or the extraordinary disposition rules under §1.245A-5, or because the taxpayer seeks to, for example, preserve PTEP or other earnings and profits to cover a future distribution.

D. The Final Regulations

The Final Regulations apply to certain triangular reorganizations in which a subsidiary (S) purchases, in connection with the reorganization, stock or securities of its parent corporation (P) in exchange for property and exchanges the stock or securities of P for the stock or property of a target corporation (T), but only if P or S (or both) is a foreign corporation. The Final Regulations and this preamble refer to such exchange of stock or securities of P for property as the “P acquisition.” This preamble also refers to the P acquisition together with the related triangular reorganization as an “applicable triangular reorganization.”

When applicable, the Final Regulations require that adjustments be made that have the effect of a distribution of property from S to P under section 301 (deemed distribution), followed by a contribution from P to S of an amount equal to the deemed distribution (deemed contribution). The amount of the deemed distribution is the sum of the amount of money transferred by S, the amount of any liabilities that are assumed by S and constitute property, and the fair market value of other property that S transferred to P in the P acquisition. The deemed distribution is treated as a dividend to the extent of S’s earnings and profits.

There are several exceptions to the application of the Final Regulations. Under §1.367(b)-10(a)(2)(iii) (the section 367(a) priority rule), the Final Regulations do not apply to transactions otherwise described in the Final Regulations if the amount of gain that T’s shareholders would recognize under section 367(a)(1) is at least equal to the sum of the amount of the deemed distribution that P would treat as a dividend under section 301(c)(1) and the amount of the deemed distribution that P would treat as gain under section 301(c)(3) were the Final Regulations to apply. This preamble refers to the hypothetical amount of gain recognized under section 367(a)(1) and the hypothetical amount of the deemed distribution treated either as dividend or gain under section 301(c).
as “section 367(a) income” and “section 367(b) income,” respectively. Section 1.367(a)-3(a)(2)(iv) provides a similar priority rule (the section 367(b) priority rule) that turns off the application of section 367(a)(1) with respect to transactions described in the Final Regulations if the amount of section 367(a) income that T's shareholders would otherwise recognize under section 367(a)(1) (without regard to any exceptions thereto) is less than the amount of section 367(b) income that would result from the deemed distribution. In this way, the priority rules subject an applicable triangular reorganization to whichever section 367 regime would give rise to the most income under section 367.

Section 1.367(b)-10(a)(2)(ii) provides another exception to the application of the Final Regulations. Under this exception, the Final Regulations generally do not apply if S is a domestic corporation and P would not be subject to U.S. tax on a dividend received from S. This preamble refers to this exception as the “no-U.S.-tax exception.”

The Final Regulations also contain a broad anti-abuse rule under which appropriate adjustments are made if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of the Final Regulations. See §1.367(b)-10(d). The anti-abuse rule contains an example illustrating that the earnings and profits of S may, under certain circumstances, be deemed to include the earnings and profits of a corporation related to P or S for purposes of determining the consequences of the adjustments provided for in the Final Regulations.

E. Notice 2014-32

Notice 2014-32 identified transactions designed to exploit certain aspects of the Final Regulations. In particular, Notice 2014-32 described transactions in which taxpayers applied the section 367(a) and (b) priority rules and no-U.S.-tax exception in a manner that, contrary to their intended operation, resulted in the taxpayer being subject to the more favorable of the section 367(a) or (b) regimes. Notice 2014-32 accordingly announced that regulations would be issued under section 367(b) to (i) modify the priority rules such that only section 367(b) income that would actually be subject to U.S. tax would be considered and (ii) narrow the scope of the no-U.S.-tax exception. Notice 2014-32 further announced that regulations would be issued to remove the deemed contribution rule in §1.367(b)-10(b)(2) and clarify the broad application of the anti-abuse rule in §1.367(b)-10(d).

F. Notice 2016-73

Notice 2016-73 identified additional transactions designed to exploit the Final Regulations, as modified by the rules announced in Notice 2014-32. The transactions identified in Notice 2016-73 include, as one example, a two-step transaction where an applicable triangular reorganization is followed by a purportedly unrelated inbound nonrecognition transaction to which §1.367(b)-3 applies.

In that example, USP, a domestic corporation, owns all of the stock of FP, and FP owns all of the stock of FS. Both FP and FS are foreign corporations. USP also owns all of the stock of USS, a domestic corporation, and USS owns all of the stock of FT, a foreign corporation. In step one of the example transaction, FP, FS, and FT engage in an applicable triangular reorganization that is designed to result in no section 367(b) income and only a de minimis amount of section 367(a) income. Specifically, FS acquires newly issued stock of FP for property and transfers the stock of FP to USS in exchange for all the stock of FT in a triangular reorganization described in section 368(a)(1)(B). In addition, USS files a gain recognition agreement with respect to its transfer of the stock of FT. The taxpayer takes the position that the section 367(a) priority rule applies to turn off the Final Regulations with respect to the applicable triangular reorganization and therefore does not treat FP as having received a deemed distribution. Under this position, the effect of this first step of the transaction is a transfer of property from FS to FP without a distribution that would result in a corresponding decrease in the earnings and profits of FS and increase in the earnings and profits of FP associated with that property.

In step two of the example transaction, on a later date FP transfers its assets (including the cash, note, or other property received from FS) to USP or a domestic corporation whose stock is owned directly or indirectly by USP in a nonrecognition transaction described in §1.367(b)-3. The taxpayer asserts that USP accordingly includes in its income a deemed dividend of the “all earnings and profits amount” (as described in §1.367(b)-2(d)) with respect to its stock in FP, but, because that amount does not take into account the earnings and profits of lower-tier foreign corporations, the deemed dividend does not include the earnings and profits associated with the property that FP received from FS in the P acquisition (because such earnings and profits remain at FS under the position taken by the taxpayer). The desired effect of the overall transaction is a repatriation of property from FS to USP (or a domestic corporation held by USP) without a corresponding income inclusion attributable to untaxed earnings and profits of FS.

Notice 2016-73 announced that additional regulations would be issued under section 367(b) to address transactions such as these types of two-step transactions. To address step one of the transaction, the regulations would, in addition to the modifications described in Notice 2014-32, prevent the section 367(a) priority rule from applying where T is foreign and instead subject certain T shareholders to rules under §1.367(b)-4 that could result in an income inclusion or gain recognition with respect to their exchange of T stock. To address step two of the transaction, the regulations would subject any inbound nonrecognition transaction to a new set of “excess asset basis” (EAB) rules to be issued under §1.367(b)-3 that, for purposes of determining the all earnings and profits amount, would take into account certain earnings and profits of lower-tier foreign corporations. Step two of the transaction was subject to the EAB rules because a taxpayer may have completed an applicable triangular reorganization described in step one (but not yet an inbound nonrecognition transaction described in step two) before the issuance of Notice 2016-73. Such partially completed transactions would go undetected if the regulations were limited to modifying the section 367(a) priority rule. Notice 2016-73 further announced that the EAB rules would apply to any inbound nonrecognition transaction, regardless
of whether the taxpayer had previously engaged in an applicable triangular reorganization, out of concern that transactions other than applicable triangular reorganizations might also position taxpayers to achieve an improper repatriation of property through a subsequent inbound nonrecognition transaction.

Notice 2016-73 also described a variation of the foregoing two-step transaction where the P acquisition is between FP and USP. In this variation of the transaction, FP (which has no earnings and profits) acquires stock of USP in exchange for nonqualified preferred stock of FP, and FP uses the stock of USP to acquire the stock of FT in an applicable triangular reorganization. After the applicable triangular reorganization, the taxpayer causes FP to redeem its nonqualified preferred stock from USP in exchange for cash or a note. The taxpayer takes the position that (i) the Final Regulations do not apply to FP’s transfer of nonqualified preferred stock to USP because nonqualified preferred stock is not “property” under the Final Regulations, and (ii) FP’s redemption of the nonqualified preferred stock does not cause USP to have an income inclusion because FP has no earnings and profits. The desired effect of this variation is similarly a repatriation of property from FP to USP at no U.S. tax cost.

To address this type of transaction, Notice 2016-73 announced that future regulations would modify the definition of property in §1.367(b)-10(a)(3)(ii) to include stock of S that is nonqualified preferred stock (as defined in section 351(g)(2)).

II. Rules Applicable to Inbound Nonrecognition Transactions

A. §1.367(b)-3 and Notice 2016-73

Section 1.367(b)-3 generally applies to an acquisition by a domestic corporation (the domestic acquiring corporation) of the assets of a foreign corporation (the foreign acquired corporation) in a liquidation described in section 332 or an asset acquisition described in section 368(a)(1) (in each case, an inbound nonrecognition transaction). Upon an inbound nonrecognition transaction, §1.367(b)-3 requires certain shareholders of the foreign acquired corporation to include in income as a deemed dividend the all earnings and profits amount with respect to their stock in the foreign acquired corporation.1 Under §1.367(b)-2(d), that amount is generally determined under the principles of section 1248 when computing the amount of earnings and profits attributable to stock, subject to certain adjustments. For example, the all earnings and profits amount does not take into account earnings and profits of subsidiaries of the foreign acquired corporation notwithstanding section 1248(c)(2). See §1.367(b)-2(d)(3)(ii).

Section 1.367(b)-3 is intended to ensure the appropriate carryover of tax attributes from the foreign acquired corporation to the domestic acquiring corporation. The preamble to proposed regulations issued in 1991 describes the section 367(b) principles relevant to inbound nonrecognition transactions and specifically identifies the prevention of “the repatriation of earnings and profits without tax” as one such principle. 56 FR 41993, 41996. The 1991 proposed regulations accordingly introduced the concept of including in income the all earnings and profits amount, which was intended to reflect “the proper measure of the earnings and profits [of the foreign acquired corporation] that should be subject to tax.” Id. The preamble to final regulations issued in 2000 further explained that the inclusion of the all earnings and profit amount “generally ensures that the section 381 carryover basis reflects an after-tax amount” and describes “the appropriate carryover of attributes from foreign to domestic corporations” as “the principal policy consideration of section 367(b) with respect to inbound nonrecognition transactions.” TD 8862, 65 FR 3589, 3590. Section 1.367(b)-3 therefore ensures that when asset basis is repatriated the basis either reflects after-tax earnings and profits or is accompanied by an income inclusion attributable to the untaxed earnings and profits that gave rise to that basis.

As illustrated in Notice 2016-73 and summarized above in Part I.F of the Explanation of Provisions section of this preamble, there are some circumstances where the earnings and profits of the foreign acquired corporation do not accurately reflect the basis in its assets. In particular, the earnings and profits of the foreign acquired corporation may be insufficient to the extent that earnings and profits that gave rise to the foreign acquired corporation’s asset basis reside in lower-tier foreign corporations as a result of an applicable triangular reorganization that does not give rise to a deemed distribution. Because the all earnings and profits amount does not account for the earnings and profits of lower-tier foreign corporations, a deemed dividend of the all earnings and profits amount will not have the intended effect of ensuring the appropriate carryover of asset basis in such cases.

To address this concern, Notice 2016-73 announced that §1.367(b)-3 would be modified to require certain shareholders of the foreign acquired corporation to adjust their all earnings and profits amount upon an inbound nonrecognition transaction. Specifically, an exchanging shareholder that exchanges stock in a foreign acquired corporation with respect to which there is EAB would increase its all earnings and profits amount by certain earnings and profits of lower-tier foreign corporations, referred to in Notice 2016-73 as “specified earnings.” Notice 2016-73 defined EAB as the amount by which the inside asset basis of the foreign acquired corporation exceeded the sum of its earnings and profits, its outside stock basis, and its liabilities assumed by the domestic acquiring corporation. The EAB concept is in furtherance of a balanced tax-basis balance sheet. In other words, the EAB concept recognizes that the tax basis in a corporation’s assets generally is derived from these three sources, with outside stock basis serving as a proxy for contributed capital. While basis derived from contributed capital reflects after-tax amounts (or, in the case of liabilities assumed by the domestic acquiring corporation, is expected to

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1 Certain other shareholders of the foreign acquired corporation may be required to recognize realized gain with respect to their exchanged stock. See §1.367(b)-3(c)(2).
be satisfied by after-tax amounts of the domestic acquiring corporation, basis derived from a foreign corporation’s untaxed earnings and profits might not be subject to U.S. tax until those earnings are repatriated. For this reason, a foreign corporation’s untaxed earnings and profits are subject to tax via a deemed dividend of the all earnings and profits amount. This deemed dividend inclusion in effect requires that the exchanging shareholder “pay for” the tax basis in repatriated assets before that basis is used within the U.S. tax system.

Specified earnings are defined in Notice 2016-73 as the least of the following amounts: (i) the aggregate earnings and profits of foreign subsidiaries of the foreign acquired corporation attributable to the exchanging shareholder, (ii) the amount of the foreign acquired corporation’s EAB attributable to the exchanging shareholder, and (iii) the exchanging shareholder’s built-in gain in the stock of the foreign acquired corporation. The addition of specified earnings to the all earnings and profits amount is thereby intended to correct the basis imbalance of the foreign acquired corporation by taking into account certain earnings and profits residing in foreign subsidiaries that are presumed to have given rise to the EAB. Thus, the all earnings and profits amount, after taking into account specified earnings, should more accurately reflect the asset basis of the foreign acquired corporation that is repatriated pursuant to the inbound nonrecognition transaction.

The proposed regulations generally would adopt the rules described in Notice 2016-73, modified as discussed in the remainder of this preamble. This preamble uses the term “EAB rules” to refer collectively to the modifications that are proposed to be made to §1.367(b)-3.

B. General scope of the EAB rules

As described in Notice 2016-73, the EAB rules would apply to any inbound nonrecognition transaction regardless of whether the taxpayer had previously engaged in an applicable triangular reorganization. This scope reflected the possibility that EAB policy concerns could arise as a result of other transactions and that taxpayers may attempt to achieve similar results through such other transactions.

The comment recommended that the EAB rules be applied to a narrower set of transactions, citing, among other reasons, the significant compliance burden that would otherwise be imposed on legitimate business transactions. The comment thus recommended that the EAB rules be applied only to taxpayers that had completed an applicable triangular reorganization before the issuance of Notice 2016-73 that involved a foreign target corporation; did not make adjustments that have the effect of a distribution of property from S to P; and engage in a future inbound nonrecognition transaction. If narrowed in this way, the comment further suggested that the EAB rules apply only to a transitional basis; for example, for the 10-year period following Notice 2016-73. The comment asserted that a broader application of the EAB rules would be unnecessary in light of Notice 2016-73’s proposed modification to the section 367(a) priority rule, which, by requiring adjustments for a deemed distribution whenever the target is a foreign corporation, should prevent taxpayers from separating basis from earnings and profits in future transactions. As an alternative, the comment suggested that the EAB rules be applied only to inbound nonrecognition transactions that follow an applicable triangular reorganization or other specifically enumerated transactions.

The Treasury Department and the IRS agree that it would be appropriate to narrow the scope of the EAB rules for the reasons noted in the comment. In general, the proposed regulations accordingly would limit the application of the EAB rules to those inbound nonrecognition transactions where (i) S previously acquired stock or securities of P in exchange for property in connection with a triangular reorganization and (ii) adjustments were not made that have the effect of a distribution of property from S to P under section 301. See proposed §1.367(b)-3(g)(1)(i). However, to address avoidance situations that would have been subject to the EAB rules under the broad scope announced in Notice 2016-73 (which did not predicate the application of the EAB rules on there having been an applicable triangular reorganization), the proposed regulations would also provide that the EAB rules apply to inbound nonrecognition transactions where EAB was previously created in connection with a transaction other than a triangular reorganization if the principal purpose of such other transaction was to create EAB. See proposed §1.367(b)-3(g)(1)(ii). This more limited application of the EAB rules is anticipated to relieve taxpayers from the need to comply with the EAB rules with respect to non-tax motivated transactions while still addressing the policy concerns identified in Notice 2016-73.

The proposed regulations would not adopt the comment’s suggestion to apply the EAB rules only to situations where an applicable triangular reorganization involving a foreign target was completed before the issuance of Notice 2016-73. The Treasury Department and the IRS are concerned that such a limitation would prevent the application of the EAB rules to future transactions designed to create EAB. For example, a subsequent applicable triangular reorganization could give rise to EAB where the target corporation is domestic because the section 367(a) priority rule continues to apply in that context. EAB could thus arise if the section 367(a) priority rule applies to prevent the application of the Final Regulations and P and S are both foreign corporations. An ongoing application of the EAB rules is also necessary to address the case where the target is a foreign corporation but the taxpayer asserts that its transaction is not subject to §1.367(b)-10 under a novel or unforeseen theory. For this reason, the proposed regulations also would not condition the applicability of the EAB rules on the taxpayer having participated in an applicable triangular reorganization. The proposed regulations instead would provide that the EAB rules may apply to EAB created by any triangular reorganization (provided that the other conditions described in the preceding paragraph are met—that is, S acquired stock or securities of P for property in connection with the reorganization, and adjustments were not made that have the effect of a distribution of property from S to P under section 301) and to EAB created in other transactions that have a principal purpose of creating EAB. See proposed §1.367(b)-3(g)(1).
C. EAB reduction rule

Under Notice 2016-73, all EAB with respect to a foreign acquired corporation is taken into account upon an inbound nonrecognition transaction, regardless of how the EAB arose. However, if the taxpayer could demonstrate that EAB was not attributable to property provided by a foreign subsidiary, then EAB is reduced to the extent of such EAB (the EAB reduction rule).

The comment asserted that the EAB reduction rule amounted to a presumption that all EAB originated from the earnings and profits of foreign subsidiaries. The comment stated that overcoming this presumption would place a significant burden on taxpayers because it would require a comprehensive review of the foreign acquired corporation’s historic transactions to determine the extent to which EAB should be reduced. The comment therefore recommended that the EAB rules be revised such that taxpayers be permitted to take into account only the EAB created by an applicable triangular reorganization (or any other specifically identified transaction).

The Treasury Department and the IRS expect that the more limited scope of the EAB rules set forth in the proposed regulations would address the concern reflected in the comment. As proposed in these regulations and discussed in Part II.B of the Explanation of Provisions section of this preamble, the EAB rules would apply only to those inbound nonrecognition transactions that follow certain triangular reorganizations (or other transactions having a principal purpose of creating EAB) as opposed to any inbound nonrecognition transaction. This narrower scope would substantially reduce the burden of complying with the proposed EAB rules by eliminating the need for many taxpayers to determine whether EAB exists with respect to a foreign acquired corporation.

This narrowed scope also would obviate the rationale for the EAB reduction rule, which was intended to provide relief where a taxpayer could demonstrate that EAB was not attributable to an avoidance transaction. Such a relief measure would not be appropriate under the proposed regulations, however, because the proposed regulations would apply only to tax-motivated transactions. The EAB reduction rule would therefore be removed with respect to transactions completed after the issuance of the proposed regulations. But see the EAB reduction rule in proposed §1.367(b)-3(g)(7)(ii)(C) for certain transactions completed before the issuance of the proposed regulations. The proposed regulations accordingly would provide that a taxpayer subject to the EAB rules by reason of having engaged in a triangular reorganization must take into account all EAB with respect to the foreign acquired corporation, regardless of how that EAB arose and without the ability to reduce EAB to the extent it is not attributable, directly or indirectly, to property provided by a foreign subsidiary of the foreign acquired corporation.

D. Treatment of unrelated minority shareholders

As discussed in Part II.A of the Explanation of Provisions section of this preamble, one element of the EAB computation is the amount of aggregate outside basis in the stock of the foreign acquired corporation. An exchanging shareholder that would be subject to the EAB rules would thus potentially need to identify the outside bases of other, unrelated shareholders of the foreign acquired corporation. An exchanging shareholder that would be subject to the EAB rules would thus potentially need to identify the outside bases of other, unrelated shareholders of the foreign acquired corporation. An exchanging shareholder that would be subject to the EAB rules would thus potentially need to identify the outside bases of other, unrelated shareholders of the foreign acquired corporation.

The Treasury Department and the IRS recognize that the presence of unrelated minority shareholders may create some uncertainty but expect that narrowing the application of the EAB rules to only a limited set of inbound nonrecognition transactions would appropriately address the concern reflected in the comment. The transactions of which the Treasury Department and the IRS are aware, and which the proposed regulations are generally intended to address, are typically internal restructurings that by their nature are unlikely to involve unrelated shareholders. See Notice 2016-73, Section 3. Moreover, modifying the EAB rules as the comment suggests would require additional rules to specify how an exchanging shareholder would disregard unrelated minority shareholders, thereby adding complexity to the EAB calculations to accommodate an unlikely fact pattern. Therefore, the proposed regulations would not adopt this suggestion.

E. Computation of specified earnings

As discussed in Part II.A of the Explanation of Provisions section of this preamble, the rules described in Notice 2016-73 seek to correct the basis imbalance of the foreign acquired corporation by increasing an exchanging shareholder’s all earnings and profits amount by the amount of “specified earnings.” Specified earnings are limited, in part, to the sum of the earnings and profits with respect to each foreign subsidiary of the foreign acquired corporation because PTEP is not included in earnings and profits for purposes of section 1248. See section 1248(d)(1). In other words, the rules described in Notice 2016-73 would not allow the foreign acquired corporation’s basis imbalance to be corrected by a deemed distribution of lower-tier PTEP, even though a taxpayer may have created EAB by separating asset basis from earnings and profits that are characterized as PTEP.

In light of the TCJA, which increased the prevalence of PTEP, the Treasury Department and the IRS are of the view that the policies of the EAB rules are better served if, instead of adjusting an exchanging shareholder’s all earnings and profits amount as described in Notice 2016-73, the foreign acquired corporation is treated as receiving a deemed distribution under section 301 of its foreign subsidiaries, and the exchanging shareholder then accounts for the effects of the deemed distribution in the inbound nonrecognition transaction. Such a deemed
distribution more accurately addresses the basis imbalance of the foreign acquired corporation because the deemed distribution may be sourced from both PTEP and non-PTEP earnings and profits, reflecting that the basis imbalance may be associated with either type of earnings and profits. A deemed distribution from a foreign subsidiary to the foreign acquired corporation is also more likely to align the EAB rules with the substance of the taxpayer’s transaction because EAB generally arises where a taxpayer fails to treat a property transfer as a distribution under section 301. Furthermore, taking into account the effects of a section 301 distribution is consistent with the Final Regulations, which address applicable triangular reorganizations by taking into account the effects of a deemed distribution under section 301 from S to P.

The proposed regulations accordingly would modify the EAB rules by providing that an exchanging shareholder of the foreign acquired corporation computes its all earnings and profits amount after accounting for the effects of a deemed distribution from the foreign subsidiaries of the foreign acquired corporation to the foreign acquired corporation. See proposed §1.367(b)-3(g)(1). The deemed distribution, which occurs immediately before the inbound nonrecognition transaction, would be equal to the amount of “specified earnings.” The term specified earnings would be defined under the proposed regulations as the lesser of (i) the aggregate earnings and profits of foreign subsidiaries of the foreign acquired corporation (with no exclusion for those earnings and profits characterized as PTEP) (collectively, lower-tier earnings), and (ii) the EAB of the foreign acquired corporation. See proposed §1.367(b)-2(g)(2)(vii). The limitations on specified earnings described in Notice 2016-73 and Part IIA of the Explanation of Provisions section of this preamble (other than the EAB limitation, which is retained with modification) are removed because those limitations, which were designed in part to approximate a reasonable allocation of EAB among the shareholders of the foreign acquired corporation, are not necessary where the foreign acquired corporation’s basis imbalance is addressed by a deemed distribution. Thus, for example, the definition of specified earnings in the proposed regulations would not be limited to the earnings and profits of each foreign subsidiary attributable under section 1248(c)(2) to the stock of the foreign acquired corporation exchanged, but instead would include all of the earnings and profits of lower-tier foreign subsidiaries (and therefore does not exclude PTEP). The proposed regulations would adopt this approach because under the deemed distribution model all such earnings and profits would be available to increase the earnings and profits of the foreign acquired corporation if actually distributed to it through the chain of ownership.

Where specified earnings are drawn from multiple foreign subsidiaries, specified earnings would be drawn from all foreign subsidiaries on a pro rata basis (in proportion to each foreign subsidiary’s share of aggregate earnings and profits of the foreign subsidiaries). See proposed §1.367(b)-3(g)(3). In addition, and consistent with §1.367(b)-2(e)(2), specified earnings drawn from foreign subsidiaries would be treated as being distributed to the foreign acquired corporation through all tiers of intermediate owners, rather than directly to the foreign acquired corporation. See proposed §1.367(b)-3(g)(1).

The Treasury Department and the IRS are aware that limiting the amount of the deemed distribution by the amount of lower-tier earnings would preclude the deemed distribution from giving rise to a return of basis under section 301(c)(2) or gain recognition under section 301(c)(3) and in that respect would differ from the deemed distribution described in the Final Regulations. See §1.367(b)-10(b). The approach taken in the proposed regulations reflects administrability concerns that could arise from adopting a more complete distribution model which could require, for example, rules to allocate the appropriate amount of basis recovery and section 301(c)(3) gain among tiers of foreign subsidiaries. That additional complexity may not be justified when balanced against the limited application of the EAB rules, which apply only where a taxpayer has previously engaged in a transaction described in proposed §1.367(b)-3(g)(1). The Treasury Department and the IRS continue to study transactions that could give rise to EAB, including whether EAB principles should be applied to other types of inbound nonrecognition transactions.

**F. Definition of foreign subsidiary**

Notice 2016-73 used, but did not define, the term “foreign subsidiary” when referring to entities held by the foreign acquired corporation for purposes of computing specified earnings and making adjustments to EAB. The proposed regulations similarly use the term “foreign subsidiary” for purposes of the EAB rules and would define the term based, in part, on the ownership rules in section 1248(c)(2)(B). See proposed §1.367(b)-3(g)(2)(ii).

**G. EAB anti-abuse rule and prohibition against affirmative use**

Notice 2016-73 announced that an anti-abuse rule would address transactions engaged in with a view to avoid the purposes of the EAB rules. As described in Notice 2016-73, the anti-abuse rule would provide for adjustments, including disregarding the effects of transactions, to carry out the purposes of the EAB rules. As one example, the anti-abuse rule stated that a transaction engaged in with a view to reduce EAB would be disregarded for purposes of computing EAB.

The comment requested that the Treasury Department and the IRS clarify the scope of the anti-abuse rule and purpose of the EAB rules. While the comment acknowledged that §1.367(b)-3 is intended to ensure that a domestic acquiring corporation does not succeed to the asset basis of the foreign acquired corporation unless the earnings and profits associated with such basis have been subject to U.S. tax, the comment asserted that it was unclear if certain transactions that would reduce EAB would violate this purpose. The comment provided several examples of such transactions, including a section 332 liquidation of a foreign subsidiary into the foreign acquired corporation. The comment explained that, if the liquidated subsidiary has high outside basis in its stock but low inside basis in its assets, then the liquidation would reduce the foreign acquired corporation’s EAB because the subsidiary’s high outside stock basis
would be eliminated and replaced with its low inside asset basis.

The Treasury Department and the IRS are of the view that the more limited scope of the EAB rules set forth in the proposed regulations would largely mitigate the concern reflected in the comment, because under the proposed regulations, the EAB rules would apply only where a taxpayer has created EAB in an earlier tax-motivated transaction, thereby significantly narrowing the context in which the anti-abuse rule may apply. With respect to the limited cases that would be subject to the EAB rules, the Treasury Department and the IRS continue to see a need to prevent transactions engaged in with a view to reducing EAB, which could lead to results inconsistent with the purposes articulated in Notice 2016-73 and in Part II.A of the Explanation of Provisions section of this preamble; that is, ensuring the appropriate carryover of tax attributes from the foreign acquired corporation to the domestic acquiring corporation.

The Treasury Department and the IRS are also aware of transactions that may attempt to affirmatively apply the EAB rules to avoid Federal income tax. The proposed regulations accordingly would provide that a taxpayer may not apply the EAB rules to a transaction if the taxpayer created EAB with a principal purpose of avoiding any tax imposed under the Code. See proposed §1.367(b)-3(g)(5).

H. Notice reporting

Section 1.367(b)-1(c) requires that certain participants to a “section 367(b) exchange” (as defined in §1.367(b)-1(a)) disclose information concerning such exchange on a statement attached to a timely filed Federal tax return or Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations), as applicable, in the taxable year in which income is realized in the exchange (such statement, the section 367(b) notice). To enhance compliance and administration with respect to the EAB rules, the proposed regulations would require that the section 367(b) notice include certain information related to EAB, including how it arose and how the amount was determined. See proposed §1.367(b)-1(c)(4)(ix). The proposed regulations also would extend the section 367(b) notice requirement to participants in transactions that implicate §1.367(b)-10, as discussed in Part III.E of the Explanation of Provisions section of this preamble.

I. Exchange gain or loss with respect to PTEP

In general, §1.367(b)-2(j)(2)(ii) provides that, if an exchanging shareholder that is a foreign corporation includes in income a deemed dividend of either the all earnings and profits amount under §1.367(b)-3 or the section 1248 amount under §1.367(b)-4, the exchanging shareholder is treated as receiving a deemed distribution of PTEP from the appropriate foreign corporation (deemed PTEP distribution). However, if the exchanging shareholder that has an income inclusion is a United States person, the exchanging shareholder is treated as receiving the deemed PTEP distribution solely for the purpose of computing exchange gain or loss under section 986(c). See §1.367(b)-2(j)(2)(i). Because the deemed PTEP distribution is created where there is an income inclusion, however, a taxpayer might assert that no exchange gain or loss is recognized under §1.367(b)-2(j)(2)(i) where the all earnings and profits amount or section 1248 amount is zero, even though the exchange gain or loss would have been recognized had all the earnings and profits or the section 1248 amount been a positive number. The proposed regulations therefore would clarify that there is a deemed PTEP distribution under §1.367(b)-2(j)(2)(i) regardless of whether the all earnings and profits amount or the section 1248 amount is greater than zero. A similar change would be made to §1.367(b)-2(j)(2)(ii).

The Treasury Department and the IRS are studying more broadly the treatment of section 986(c) amounts and PTEP in transactions subject to section 367(b) and request comments on the application of §1.367(b)-2(j)(2) more generally.

J. Calculation of net investment income under section 1411

The Treasury Department and the IRS are also concerned that in certain exchanges subject to section 367(b), earnings and profits that are characterized as PTEP might not be taken into account for purposes of calculating net investment income (NII) under section 1411. In cases where an exchanging shareholder does not make the election described in §1.1411-10(g), a distribution that would otherwise constitute a distribution of PTEP under section 959(a)—and thus would not be treated as a dividend for purposes of chapter 1 of the Code under section 959(d)—generally is treated as a dividend for purposes of calculating NII. See §1.1411-10(c)(1)(i)(A)(I). This rule seeks to preserve the NII tax base, as amounts that are characterized as PTEP will not also have been previously taxed under section 1411 (absent the election in §1.1411-10(g)) and so should be included in NII.

The NII tax base may not be fully preserved, however, in certain exchanges subject to section 367(b). For example, an inbound asset reorganization subject to §1.367(b)-3 will eliminate earnings and profits that are characterized as PTEP without creating a deemed distribution of those earnings, because PTEP is excluded from the all earnings and profits amount. See §1.367(b)-2(d)(2)(ii). An exchanging shareholder would thus never recognize a dividend of those earnings for purposes of calculating NII; further, gain that the exchanging shareholder may recognize on a subsequent sale of stock of the domestic acquiring corporation may be netted against certain losses (as NII includes net gains, but gross income from dividends).

Certain foreign-to-foreign transactions described in §1.367(b)-4, or section 355 distributions described in §1.367(b)-5, could similarly fail to preserve the NII tax base because PTEP is also excluded from the section 1248 amount. See §1.367(b)-2(c)(1). For example, while an exchanging shareholder’s annual PTEP accounts would not be eliminated as a result of a foreign-to-foreign transaction that results in a loss of section 1248 shareholder or CFC status, an exchanging shareholder could nevertheless distort the character of its NII by selling its stock in the foreign acquiror before its PTEP is distributed. The proposed regulations therefore would modify §1.1411-10(c)(3) such that (with respect to stock of a foreign corporation for which an election under §1.1411-10(g) is not in effect) the
all earnings and profits amount and the section 1248 amount include PTEP for purposes of section 1411, consistent with how section 1248 is applied in this context. See proposed §1.1411-10(c)(3)(ii). The proposed regulations also would provide for conforming basis adjustments for purposes of section 1411. See proposed §1.1411-10(d)(5).2

III. Rules Applicable to Triangular Reorganizations

A. Priority rules

As discussed in Notice 2016-73 and summarized in Part I.F of the Explanation of Provisions section of this preamble, the Treasury Department and the IRS are aware of transactions that are designed to repatriate basis without a corresponding repatriation of the earnings and profits associated with that basis. As part of these transactions, the taxpayer exploits the section 367(a) priority rule by filing a gain recognition agreement with respect to all, or all but a de minimis amount, of the foreign target corporation stock exchanged in the applicable triangular reorganization. The taxpayer accordingly recognizes no, or a de minimis amount of, section 367(a) income with respect to the target stock. Because the taxpayer also takes the position that a deemed distribution would not result in any section 367(b) income, the taxpayer applies the section 367(a) priority rule to prevent the application of the Final Regulations. The taxpayer also takes the position that the anti-abuse rule would not apply to cause this transaction to be subject to §1.367(b)-10 and therefore does not make adjustments that have the effect of a distribution of property from S to P, with the result that S would have transferred property to P without a corresponding transfer of the earnings and profits associated with that property.

Notice 2016-73 announced that future regulations would modify the section 367(a) priority rule such that it would not apply to an applicable triangular reorganization involving a foreign target corporation. Any such applicable triangular reorganization would thus be subject to the Final Regulations with the result that adjustments would be made that have the effect of a distribution of property from S to P under section 301. A similar modification was announced with respect to the section 367(b) priority rule.

The comment supported the proposed modification to the section 367(a) priority rule. As an alternative, the comment suggested that the existing formulation of the section 367(a) priority rule (that is, without taking into account the modifications described in Notice 2014-32 that would limit the “amount” of section 367(a) income to the amount giving rise to U.S. tax) be retained in cases where the target is a foreign corporation. Under that formulation, the “amount” of section 367(a) income is compared to the “amount” of section 367(b) income, regardless of whether such amounts are subject to U.S. tax. The comment asserted that this formulation would cause a greater amount of section 367(b) income to be taken into account, thereby making it more difficult for taxpayers to exploit the section 367(a) priority rule to avoid the Final Regulations.

The Treasury Department and the IRS expect that the modification to the section 367(a) priority rule described in Notice 2016-73 would best address such exploitation by ensuring that adjustments that have the effect of a deemed distribution of property from S to P are made whenever the target is a foreign corporation. This result would reinforce one of the purposes of the Final Regulations by ensuring that property transfers that are in substance distributions are treated as such, thereby preventing the separation of property from the earnings and profits associated with that property. The comment’s alternative approach could also, as the comment acknowledged, invite the avoidance of section 301(c)(2) basis reduction in situations where a small amount of section 367(a) income is compared to a large amount of section 301(c)(2) basis reduction. Because a return of basis is not considered section 367(b) income, a small amount of section 367(a) income could be sufficient to trigger the section 367(a) priority rule. Accordingly, the proposed regulations would adopt the modifications to the section 367(a) and section 367(b) priority rules described in Notice 2016-73. See proposed §§1.367(a)-3(a)(2)(iv) and 1.367(b)-10(a)(2)(iii).

As discussed in Part I.E of the Explanation of Provisions section of this preamble, Notice 2014-32 announced that the section 367(a) and section 367(b) priority rules would be modified to take into account only the portion of a distribution that would be actually subject to U.S. tax, including the extent to which a distribution would give rise to an inclusion under section 951(a) that would be subject to U.S. tax. In light of the TCJA, the proposed regulations also would modify the priority rules to take into account the extent to which a distribution would give rise to an inclusion under section 951(a) that would be subject to U.S. tax (even though it is unlikely that a distribution from S to P would give rise to a section 951(a) inclusion).

B. §1.367(b)-4 and Notice 2016-73

1. Overview

Notice 2016-73 announced that regulations to be issued under §1.367(b)-4 would apply to the exchange of a foreign target corporation’s stock that occurs in connection with an applicable triangular reorganization. As described in Notice 2016-73, the regulations under §1.367(b)-4 would require all shareholders of the target corporation to both include in income as a deemed dividend the section 1248 amount with respect to the target stock exchanged and, after taking into account the increase in basis resulting from such deemed dividend, recognize all realized gain with respect to such stock that would not otherwise be recognized. This treatment would be required only to the extent that the target shareholders exchanged target stock for P stock or securities that S previously acquired for property in the P acquisition (tainted P stock or securities); section 367(a) would continue to apply to the exchange of target stock to the extent the target shareholders did not receive such tainted P stock or securities.

1The Treasury Department and the IRS recognize that certain rules in §1.1411-10 involving domestic partnerships and certain S corporations have not been updated to reflect changes made to the application of §1.958-1 pursuant to TD 9866, 84 FR 29288, and TD 9960, 87 FR 3648, and intend to update them in a future guidance project.
The proposed regulations would adopt the rules as described in Notice 2016-73 without significant modification. See proposed §1.367(b)-4(g).

2. Authority under section 367

The comment questioned whether section 367(b) could be applied to an applicable triangular reorganization in a manner that both requires adjustments that have the effect of a distribution of property from S to P and requires the shareholders of a foreign target corporation to recognize the full amount of gain with respect to the target corporation stock that is exchanged for tainted P stock or securities. The comment asserted that this application of section 367(b) effectively achieves the same result as if the applicable triangular reorganization were concurrently subject to taxation under both section 367(b) (with respect to the P acquisition) and section 367(a) (with respect to the target shareholders’ exchange of target stock). According to the comment, section 367 may not apply to cause such concurrent taxation because the statutory language in section 367(b) (1) provides that section 367(b) may apply only where there is no transfer of property described in section 367(a). The comment cited to §1.367(a)-3(b)(2), under which transactions that could be subject to tax under both section 367(a) and (b) are subject to taxation under only one of those sections. The comment also noted that the section 367(a) and (b) priority rules, as currently effective, likewise operate in a manner that results in only one or the other of section 367(a) or (b) applying to an applicable triangular reorganization.

The Treasury Department and the IRS are of the view that the proposed application of §1.367(b)-4 is appropriate and within section 367’s statutory grant of authority. Under section 367(a)(5), the Secretary has broad authority to exempt certain transactions from the application of section 367(a)(1) in order to carry out the purposes of section 367(a). Deliberately failing to file a gain recognition (or filing a partial gain recognition agreement) to exploit the section 367(a) priority rule is inconsistent with the purposes of section 367(a), and section 367(b) is better suited to address these transactions. Accordingly, it is appropriate to exercise the authority in section 367(a)(5) to make the section 367(a) priority rule inapplicable to certain exchanges of target stock. Section 367(b) may therefore apply to the target shareholders’ exchange of target stock because the exchange, by virtue of section 367(a) (5), is not described in section 367(a)(1). See section 367(b)(1). Furthermore, section 367(b)(1) is clear that the Secretary may issue any regulations “which are necessary or appropriate to prevent the avoidance of Federal income taxes.” Section 367(b)(2) provides that such regulations “shall include . . . the circumstances under which gain shall be recognized currently, or amounts included in gross income currently as a dividend, or both . . . .” Nothing within this broad grant of rulemaking authority prevents section 367(b) from concurrently applying to both the P acquisition and the exchange of target stock such that both of these components of an applicable triangular reorganization give rise to income or gain.

3. Section 367(b) policy

The comment further asserted that requiring adjustments that have the effect of a distribution of property from S to P where the target is a foreign corporation sufficiently addresses the concerns raised in Notice 2016-73 and thus questioned the rationale in also subjecting the target shareholders to current taxation under §1.367(b)-4. According to the comment, the target shareholders remain subject to U.S. taxing jurisdiction through their carryover basis in the stock of P and continued indirect equity interest in the target. The comment claimed that historic section 367(b) policy has recognized the permissibility of deferral where U.S. taxing rights remain intact, and in particular where section 1248 amounts are preserved.

The Treasury Department and the IRS maintain that it is appropriate for the proposed regulations to require all target shareholders to recognize the full amount of their gain in the stock of the target corporation in connection with such transactions, not only with respect to S’s acquisition of the stock of P but also with respect to the exchange of stock of T. See Notice 2006-85; Notice 2014-32 (addressing situations where taxpayers attempted to manipulate the section 367(b) priority rule to effectuate an inversion without the T shareholders being subject to §1.367(a)-3(c)). Moreover, a more limited application of the rules under section 367 has led to repeated attempts by taxpayers to structure around the rules. Requiring all target shareholders to recognize the full amount of their gain in the stock of the target corporation in connection with such transactions limits opportunities to selectively trigger this gain.

C. Deemed contribution rule

Initially proposed in Notice 2007-48 (2007-25 IRB 1428), the deemed contribution rule in §1.367(b)-10(b)(2) was intended to address the scenario where S purchases P stock or securities from a person other than P (for example, from the public on the open market) instead of directly from P itself. In such cases, the adjustments required by the deemed distribution effectively adopt a “consent dividend” model, which would treat P as receiving a distribution of property from S even though P did not actually receive the property transferred in the P acquisition. The deemed contribution rule, under this model, accounts for P’s lack of property by requiring adjustments that have the effect of a contribution of property (with no built-in gain or loss) by P to S in an amount equal to the amount of the deemed distribution. In particular, these adjustments require that P increase its basis in its S stock by the amount of the deemed contribution. Under the Final Regulations, the deemed contribution rule applies regardless of whether S acquires P stock or securities from P or from a person other than P.

As discussed in Notice 2014-32, the Treasury Department and the IRS are aware of transactions designed to avoid U.S. tax by exploiting the deemed contribution rule. In one such transaction,
for example, S has no earnings and profits but a high outside stock basis. The taxpayer effects an applicable triangular reorganization where the amount of property transferred to P in the P acquisition is less than the amount of the outside stock basis in S. The taxpayer applies the Final Regulations to make the adjustments required by the deemed distribution, which results solely in a return of the outside stock basis in S under section 301(c)(2). The adjustments required by the deemed contribution rule, however, immediately restore that basis. The applicable triangular reorganization thus does not result in a net reduction to the outside stock basis in S, effectively negating the intended consequences of the deemed distribution. Further, the taxpayer could attempt to repeatedly effect applicable triangular reorganizations to transfer property from S to P with no net reduction to the outside stock basis in S despite each transaction being treated as a deemed distribution. As a result, and consistent with the regulations announced in Notice 2014-32, the proposed regulations remove the deemed contribution rule.

D. Anti-abuse rule

The Final Regulations contain an anti-abuse rule under which appropriate adjustments are made if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of the Final Regulations. See §1.367(b)-10(d). The anti-abuse rule contains an example illustrating that the earnings and profits of S may, under certain circumstances, be deemed to include the earnings and profits of a corporation related to P or S for purposes of determining the consequences of the adjustments provided for in the Final Regulations.

As illustrated in Notice 2014-32 and Notice 2016-73, taxpayers have taken the position that the anti-abuse rule does not apply to a given transaction under the theory that the one example provided by the anti-abuse rule does not explicitly describe the transaction. Notice 2014-32 accordingly announced that future regulations would clarify that the anti-abuse rule may apply broadly to support a variety of adjustments, including adjusting earnings and profits between previously unrelated corporations. The proposed regulations would implement the clarifications to the anti-abuse rule described in Notice 2014-32.

To illustrate the broad application of the anti-abuse rule, the proposed regulations would include additional examples. First, the proposed regulations would add an example illustrating that the anti-abuse rule may apply to a “downstream” transfer of property made in connection with a triangular reorganization. Because a downstream transfer (whereby property being separated from earnings and profits is initially transferred downstream, rather than upstream from S to P) can be structured so as not to fall within the literal application of the Final Regulations, which equate the P acquisition with a section 301 distribution, taxpayers otherwise might assert that a downstream transfer of property made in connection with a triangular reorganization cannot be subject to the Final Regulations. See proposed §1.367(b)-10(d)(3) (Example 2). The proposed regulations also would add an example illustrating that certain debt exchanges may implicate the anti-abuse rule. See proposed §1.367(b)-10(d)(4) (Example 3).

For the avoidance of doubt, the application of the anti-abuse rule is not limited to the particular fact patterns described in the examples. In addition, the proposed regulations would not modify the operative text of the anti-abuse rule, which remains unchanged from the Final Regulations, such that the examples included in the proposed regulations would illustrate transactions subject to the anti-abuse rule.

E. Other rules

Notice 2014-32 described transactions designed to avoid the application of the no-U.S.-tax exception in §1.367(b)-10(a)(2)(ii) and also expressed a concern that taxpayers may attempt to interpret that exception in a narrower manner than was intended or is appropriate. Notice 2014-32 accordingly announced that future regulations would modify the no-U.S.-tax exception, in part to clarify its scope. The proposed regulations would adopt the modifications to the no-U.S.-tax exception described in Notice 2014-32. See proposed §1.367(b)-10(a)(2)(ii).

As noted above in Part I.F of the Explanation of Provisions section of this preamble, Notice 2016-73 announced that the definition of “property” in §1.367(b)-10(a)(3)(iii) would be modified to include nonqualified preferred stock of S. The proposed regulations would adopt this rule without modification. See proposed §1.367(b)-10(a)(3)(ii)(C).

Section 1.367(b)-10(b)(3) provides that the deemed distribution is generally treated as occurring immediately before the P acquisition, and Notice 2016-73 requested comments on whether this rule should be modified in light of the modifications announced in the notice. The comment suggested that the current rule be retained because no reason has been identified to warrant its modification. The Treasury Department and the IRS agree with the comment and therefore no changes would be made with respect to this rule.

The proposed regulations also would modify the reporting requirements under §1.367(b)-1(c) to require corporations that acquire stock or securities of P in a transaction described in the Final Regulations to disclose such acquisitions by attaching a section 367(b) notice (within the meaning of §1.367(b)-1(c)) to the corporation’s tax return (or Form 5471, as applicable) for the year in which the stock or securities of P are acquired. See proposed §1.367(b)-1(c)(2)(vi). Under the proposed regulations, corporations would be required to describe the circumstances of the acquisition of stock or securities of P, any related transactions involving the acquired stock or securities, and whether any adjustments were made pursuant to §1.367(b)-10. See proposed §1.367(b)-1(c)(4)(viii). The information required to be disclosed would supplement (rather than replace) any information already required to be disclosed in the section 367(b) notice.

IV. Applicability Dates

With respect to those rules described in Notice 2014-32, the proposed regulations generally would be applicable to transactions completed on or after April 25, 2014, subject to limited exceptions. See proposed §§1.367(a)-3(g)(1)(viii) and 1.367(b)-10(e)(2).
With respect to those rules described in Notice 2016-73, the proposed regulations generally would be applicable to transactions completed on or after December 2, 2016. See proposed §§1.367(a)-3(g)(1)(viii), 1.367(b)-3(g)(7)(i), 1.367(b)-4(i), and 1.367(b)-10(e)(3). To the extent the proposed regulations contain rules not previously announced in Notice 2016-73, the proposed regulations would be applicable to transactions completed on or after the date the proposed regulations are filed in the Federal Register. See proposed §§1.367(b)-3(g)(7)(i), 1.367(b)-6(a)(1)(v) and (vi), and 1.1411-10(i); see also proposed §1.367(b)-3(g)(7)(ii) for transition rules for certain transactions completed before the issuance of the proposed regulations.

Taxpayers and their related parties (within the meaning of sections 267(b) and 707(b)(1)) may choose to apply the rules of Notice 2014-32 and Notice 2016-73 or the proposed regulations to any open taxable year beginning before the date the proposed regulations are filed as final regulations in the Federal Register, provided that taxpayers and their related parties consistently apply either the entirety of Notice 2014-32 and Notice 2016-73 or the entirety of the proposed regulations for such years and each subsequent taxable year beginning before the date the proposed regulations are filed as final regulations in the Federal Register.

The comment requested that the Treasury Department and IRS reconsider the December 2, 2016, applicability date given that Notice 2016-73 proposed to apply the EAB rules to all inbound nonrecognition transactions, regardless of whether the taxpayer had previously effected an applicable triangular reorganization. The comment did, however, recognize the immediate need for the EAB rules to apply to already-completed applicable triangular reorganizations where the taxpayer did not apply the Final Regulations. Because the proposed regulations would apply the EAB rules only to those inbound nonrecognition transactions that follow certain triangular reorganizations and other transactions designed to create EAB, the Treasury Department and IRS maintain that the December 2, 2016, effective date is appropriate.

No inference is intended regarding the treatment of applicable triangular reorganizations, transactions undertaken with a principal purpose of creating EAB, or subsequent inbound nonrecognition transactions completed before the applicability date of the proposed regulations. Such transactions may be subject to challenge before the applicability dates, for example, under the anti-abuse rule in §1.367(b)-10(d), applicable Code provisions, or judicial doctrines.

Effect on Other Documents

The proposed regulations would, as of the date they are filed as final regulations with the Federal Register, obsolete Notice 2014-32 and Notice 2016-73. Until such time, taxpayers may continue to rely on Notice 2014-32 and Notice 2016-73 as noted in Part IV of the Explanation of Provisions section of this preamble.

Special Analyses

I. Regulatory Planning and Review – Economic Analysis

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) (PRA) requires that a Federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit.

The collections of information in the proposed regulations are in proposed §1.367(b)-1(c)(4)(viii) and (ix) and apply to taxpayers that engage in transactions described in the proposed regulations for such years and each subsequent taxable year beginning before the date the proposed regulations are filed with the Federal Register. The proposed information collection is a statement by corporations attached to their timely filed Federal tax returns (or Form 5471, as applicable) that describes certain transactions and computations relevant to the proposed regulations. Because such statements have not been required for transactions that predate the proposed regulations, the Treasury Department and the IRS are limited in their ability to estimate how many taxpayers are likely to be affected by the proposed information collection. Based on available data and the profile of taxpayers that have historically undertaken the types of transactions at issue (large, publicly traded corporations), it is estimated that no more than 50 taxpayers would be affected by the proposed information collection in a given year. The likely respondents are foreign and domestic corporations.

Because the collections of information in proposed §1.367(b)-1(c)(4)(viii) and (ix) are proposed to apply to taxable years ending on or after the date the proposed regulations are filed with the Federal Register, the Treasury Department and the IRS have submitted the collection of information in proposed §1.367(b)-1(c)(4)(viii) and (ix) to the OMB for review in accordance with the PRA and requested a temporary OMB control number (1545-NEW). After the rulemaking is finalized, burdens associated with the proposed information collection will be incorporated into OMB control number 1545-0123. OMB control number 1545-0123 represents a total estimated burden time for all forms and schedules and regulations for corporations. REG-117614-14 will be included in the future; however, the burden estimates in 1545-0123 will not isolate the estimated burden for the information collection contained in these proposed, and subsequent final, regulations. The Treasury Department and the IRS estimate burdens based on a taxpayer-type basis rather than a provision-specific basis.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.
Commenters are strongly encouraged to submit public comments electronically. Comments and recommendations for the proposed information collection should be sent to www.reginfo.gov/public/do/PRAMain, with electronic copies to the IRS at pra.comments@irs.gov (indicate “REG-117614-14” on the subject line). This particular information collection can be found by selecting “Currently under Review - Open for Public Comments” then by using the search function. Comments can also be mailed to OMB. Attn.: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies mailed to the IRS, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by December 5, 2023.

III. Regulatory Flexibility Act

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (5 U.S.C. chapter 6) (RFA) requires the agency “to prepare and make available for public comment an initial regulatory flexibility analysis” that will “describe the impact of the proposed rule on small entities.” See 5 U.S.C. 603(a). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities. A small entity is defined as a small business, small nonprofit organization, or small governmental jurisdiction. See 5 U.S.C. 601(3) through (6).

The Treasury Department and the IRS do not have data readily available to assess the number of small entities potentially affected by the proposed regulations. However, the taxpayers affected by the proposed regulations would generally be domestic and foreign corporations that participate in certain triangular reorganizations. The triangular reorganizations at issue represent a narrow set of abusive transactions that have typically been engaged in by large, publicly traded corporations. Such transactions are highly sophisticated and are thus unlikely to involve small domestic entities. Therefore, the Treasury Department and the IRS certify that the proposed regulations would not have a significant economic impact on a substantial number of small entities. The Treasury Department and the IRS invite the public to comment on the impact of these regulations on small entities.

IV. Section 7805(f)

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

V. Unfunded Mandates Reform Act

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

VI. Executive Order 13132: Federalism

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

Comments and Requests for Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the ADDRESSES section. The Treasury Department and the IRS request comments on all aspects of the proposed rules. The Treasury Department and the IRS also invite comments on section 367(b) more generally, including whether, and if so, how, any of the existing regulations issued under section 367(b) should be modified in light of the Tax Cuts and Jobs Act. Any electronic or paper comments submitted will be made available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person who timely submits electronic or written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the Federal Register.

Statement of Availability of IRS Documents


Drafting Information

The principal author of the proposed regulations is Brady Plastaras of the Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record-keeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:
PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry for §1.1411-10 in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805

Section 1.1411-10 also issued under 26 U.S.C. 367(b).

Par. 2. Section 1.367(a)-3 is amended by revising paragraphs (a)(2)(iv) and (g)(1)(viii) to read as follows:

§1.367(a)-3 Treatment of transfers of stock or securities to foreign corporations.

(a)

(2)

(iv) Certain triangular reorganizations described in §1.367(b)-10.

(3)(i) In an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T (as defined in §1.367(b)-10(a)(3)(i)) for property in triangular reorganizations, section 367(a)(1)(A) does not apply to such U.S. persons with respect to the exchange of the stock or securities of T if the condition in paragraph (a)(2)(iv)(B) of this section is satisfied. See §1.367(b)-10(a)(2)(iii) (providing a similar rule that excludes certain transactions from the application of §1.367(b)-10).

(A) The amount of gain in the T stock or securities that would otherwise be recognized under section 367(a)(1)(A) (without regard to any exceptions thereto) pursuant to the indirect stock transfer rules of paragraph (d) of this section is less than the sum of the amount of the deemed distribution under §1.367(b)-10 that would be treated and subject to U.S. tax as a dividend under section 301(c)(1) (or would give rise to a dividend income section 951(a)(1)(A) or 951A(a) that would be subject to U.S. tax) and the amount of such deemed distribution that would be treated and subject to U.S. tax as gain from the sale or exchange of property under section 301(c)(3) (or would give rise to a capital gains inclusion under section 951(a)(1)(A) or 951A(a) that would be subject to U.S. tax) if §1.367(b)-10 would otherwise apply to the triangular reorganization.

(B) T is a foreign corporation, but only to the extent that the stock or securities of T are exchanged for stock or securities of P that were acquired by S in exchange for property in the P acquisition (as the terms P, S, property, and P acquisition are defined in §1.367(b)-10(a)(a)). Such exchange of T stock or securities is subject to the rules under §1.367(b)-10(g). Section 367(a) applies to the exchange of T stock or securities to the extent that such stock or securities are exchanged for P stock or securities that were not acquired by S in exchange for property in the P acquisition.

§1.367(b)-1 Other transfers.

(c)

(2)

(vi) A domestic or foreign corporation (S) that acquires stock or securities of another corporation (P) in a triangular reorganization described in §1.367(b)-10(a)(1), without regard to the exceptions in §1.367(b)-10(a)(2).

(4)

(v) Any information that is or would be required to be furnished with a Federal income tax return pursuant to regulations or other guidance under section 332, 351, 354, 355, 356, 361, 368, or 381 (whether or not a Federal income tax return is required to be filed), if such information has not otherwise been provided by the person filing the section 367(b) notice;

(viii) In the case of a corporation (S) described in paragraph (c)(2)(vi) of this section, the rules of this paragraph (c)(4) apply by treating the acquisition of the
stock or securities of P in exchange for property as the section 367(b) exchange referred to in paragraph (a) of this section. The section 367(b) notice must also include a complete description of the acquisition of the stock or securities of P in exchange for property, including a description of the property provided in exchange for the stock or securities and any related transactions involving the acquisition of the stock or securities. The section 367(b) notice must describe any adjustments made pursuant to §1.367(b)-10 or, if no adjustments are made, explain why no such adjustments were made; and

(ix) In the case of an exchange to which §1.367(b)-3(g) applies, a statement describing how any excess asset basis (as defined in §1.367(b)-3(g)(2)(i)) arose, the amount of excess asset basis, and a description of the computation of the amount of excess asset basis.

* * * * *

Par. 4. Section 1.367(b)-2 is amended by:

1. In paragraph (c)(1), adding a sentence after the current first sentence;
2. Adding a sentence to the end of paragraph (d)(2)(ii);
3. In paragraph (d)(3)(ii), removing the language “subsidiaries of” and adding in its place the language “corporations owned by”;
4. Adding a sentence to the end of paragraph (d)(3)(ii);
5. In paragraph (e)(4) Example 2, removing the language “foreign subsidiary” and adding in its place the language “foreign corporation”; and
6. In paragraphs (j)(2)(i) and (ii), removing the language “is required to include in income either the all earnings and profits amount or the section 1248 amount under the provisions of §1.367(b)-3 or §1.367(b)-4” and adding in its place the language “exchanges stock pursuant to a transaction described in §1.367(b)-3 or §1.367(b)-4(b)(1)(i), (b)(2)(i), (b)(3), (e), or (g)”.

The additions read as follows:

§1.367(b)-2 Definitions and special rules.

* * * * *

(c) * * *

(1) * * * But see §1.1411-10(c)(3)(ii), which for certain exchanges modifies the section 1248 amount for purposes of section 1411. * * *

* * * * *

(d) * * *

(ii) * * * But see §1.1411-10(c)(3)(ii), which for certain exchanges modifies the all earnings and profits amount for purposes of section 1411.

* * * * *

(3) * * *

(ii) * * * But see §1.367(b)-3(g)(1), which adjusts the all earnings and profits amount through a deemed distribution of certain earnings and profits of foreign subsidiaries owned by the foreign acquired corporation.

* * * * *

Par. 5. Section 1.367(b)-3 is amended by adding paragraph (g) to read as follows:

§1.367(b)-3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *

(g) All earnings and profits amount adjusted for excess asset basis—(1) General rule. If there is excess asset basis with respect to a foreign acquired corporation and the condition described in paragraph (g)(1)(i) or (ii) of this section is satisfied, then, except as provided in paragraph (g)(5) of this section, an exchanging shareholder to which paragraph (b)(3)(i) of this section applies must compute the all earnings and profits amount with respect to its stock in the foreign acquired corporation as if the foreign acquired corporation had received a distribution of property from a foreign subsidiary under section 301 in an amount equal to the specified earnings, immediately before the inbound nonrecognition transaction. The deemed distribution described in the preceding sentence is treated as occurring for all purposes of the Internal Revenue Code. For purposes of this paragraph (g)(1), the amount of the distribution from a foreign subsidiary is equal to the amount of earnings and profits of that foreign subsidiary that is designated as specified earnings under paragraph (g)(3) of this section. In the case of a foreign subsidiary the stock of which is not held directly by the foreign acquired corporation, the distribution is treated as being made through any intermediate owners. For purposes of this paragraph (g)(1), references to the foreign acquired corporation, S, and a foreign subsidiary include any predecessor corporation.

(i) S previously acquired in exchange for property stock or securities of the foreign acquired corporation in connection with a triangular reorganization described in §1.358-6(b)(2), and the foreign acquired corporation and S did not make adjustments that have the effect of a distribution of property from S to the foreign acquired corporation under §1.367(b)-10(b)(1).

(ii) The excess asset basis is attributable, directly or indirectly, to property previously provided by a foreign subsidiary of the foreign acquired corporation in connection with a transaction not described in paragraph (g)(1)(i) of this section and undertaken with a principal purpose to create such excess asset basis.

(2) Definitions. The following definitions apply for purposes of this paragraph (g).

(i) Excess asset basis. The term excess asset basis means, with respect to a foreign acquired corporation, the amount by which the inside asset basis of that corporation exceeds the sum of the following amounts:

(A) The earnings and profits of the foreign acquired corporation attributable to its outstanding stock. For purposes of paragraph (g)(2)(i) of this section, such earnings and profits are determined under the principles of §1.367(b)-2(d) but without regard to whether the exchanging shareholder is described in paragraph (b)(1) of this section or whether the exchanging shareholder is a U.S. person or a foreign person; and such earnings and profits include amounts described in section 1248(d)(3) or (4).

(B) The aggregate basis in the outstanding stock of the foreign acquired corporation determined immediately before the nonrecognition transaction described in paragraph (a) of this section (the inbound nonrecognition transaction) and therefore without regard to any basis increase described in §1.367(b)-2(e)(3)(ii) resulting from such inbound nonrecognition transaction.
(C) The aggregate amount of liabilities of the foreign acquired corporation that are assumed (determined under the principles of section 357(d)) by the domestic acquiring corporation in the inbound nonrecognition transaction.

(ii) Foreign subsidiary. The term foreign subsidiary means, with respect to a foreign acquired corporation, a foreign corporation with respect to which the foreign acquired corporation satisfies the ownership requirements of section 1248(c)(2)(B) but for this purpose treating the foreign acquired corporation as the United States person referred to in section 1248(c)(2)(B).

(iii) Inbound nonrecognition transaction. The term inbound nonrecognition transaction has the meaning set forth in paragraph (g)(2)(ii)(B) of this section.

(iv) Inside asset basis. The term inside asset basis means, with respect to a foreign acquired corporation, the aggregate of the adjusted basis of all the assets of that corporation in the hands of the domestic acquiring corporation determined immediately after the inbound nonrecognition transaction.

(v) Lower-tier earnings. The term lower-tier earnings means, with respect to a foreign acquired corporation, the sum of the earnings and profits (including deficits) of each foreign subsidiary.

(vi) S. The term S has the same meaning as in §1.367(b)-10(a)(3)(i).

(vii) Specified earnings. The term specified earnings means, with respect to a foreign acquired corporation, the lesser of the following amounts:

(A) Lower-tier earnings; and

(B) The excess asset basis of the foreign acquired corporation.

(viii) Property. The term property has the same meaning as in §1.367(b)-10(a)(3)(ii).

(3) Designation of specified earnings. If lower-tier earnings exceed specified earnings, then the portion of lower-tier earnings that is designated as specified earnings is determined by reference to the earnings and profits of each foreign subsidiary on a pro rata basis in proportion to each subsidiary’s share of lower-tier earnings.

(4) Anti-abuse rule. Appropriate adjustments are made pursuant to this section if a transaction is engaged in with a view to avoid the purposes of this paragraph (g).

For example, if a transaction is engaged in with a view to reduce excess asset basis, including by increasing the basis in the stock of the foreign acquired corporation without a corresponding increase in the basis of the assets of the foreign acquired corporation, that increase in the basis in the stock of the foreign acquired corporation will be disregarded for purposes of computing excess asset basis.

(5) Prohibition against affirmative use. This paragraph (g) does not apply to an inbound nonrecognition transaction if a transaction described in paragraph (g)(1) of this section was entered into with a principal purpose of subjecting the inbound nonrecognition transaction to this paragraph (g). For example, this paragraph (g) will not apply to an inbound nonrecognition transaction if a taxpayer engaged in a transaction described in paragraph (g)(1) of this section with a principal purpose of accessing tax attributes of lower-tier foreign subsidiaries by reason of a deemed distribution of lower-tier earnings of the foreign acquired corporation.

(6) Examples. The application of this paragraph (g) is illustrated by the examples in this paragraph (g)(6). In each example, all corporations have a calendar year-end and use the United States dollar as their functional currency.

(i) Example 1—(A) Facts. USP, a domestic corporation, owns all of the stock of USS, also a domestic corporation, and 80 percent of the stock of FP, a foreign corporation. USS owns the remaining 20 percent of the stock of FP. FP owns all of the stock of FS1, which in turn owns all of the stock of FS2. Both FS1 and FS2 are foreign corporations. In a reorganization described in section 368(a)(1)(F) (F reorganization), US Newco, a newly formed domestic corporation, acquires all of the assets of FP solely in exchange for stock of US Newco, which FP distributes to USP and USS in liquidation. Immediately before the F reorganization, the stock of FP, the stock of USS, and the stock of FP owned by USP has a fair market value of $80x, $35x, and $4x, respectively. FP holds assets with an adjusted basis of $95x, has no liabilities, and has $40x of earnings and profits attributable to its outstanding stock. FS1 and FS2 have $30x and $70x of earnings and profits, respectively, all of which are described in section 959(c)(3). Dividends paid by FS2 to FS1, and by FS1 to FP, would qualify for the exception to foreign personal holding company income under section 954(c)(6). Before the applicability date described in paragraph (g)(7)(i) of this section, and separate from the F reorganization, FS1 provided property to FP in exchange for stock of FS2 in connection with a tri- angular reorganization described in §1.367(b)-2(b), and neither FP nor FS1 made adjustments that had the effect of a distribution of property from FS1 to FP under §1.367(b)-10(b)(1).

(B) Analysis—(1) All earnings and profits amount. The F reorganization is an asset acquisition described in section 368(a)(1) and is thus subject to section 367(b) and this section. Under paragraph (b) (3) of this section, USP and USS each must include in income as a deemed dividend the all earnings and profits amount with respect to their stock of FP. Because there is excess asset basis with respect to FP as if FP had received a distribution of specified earnings, immediately before the F reorganization. Because the stock of FS2 is indirectly owned by FP, to the extent the specified earnings are determined by reference to the earnings and profits of FS2, FS2 is treated as making a distribution to FS1 under section 301, and FS1 is then treated as making a distribution to FP under section 301 in an amount equal to the sum of the amount of specified earnings determined by reference to the earnings and profits of FS1 (determined without regard to the deemed distribution from FS2) and the amount of the deemed distribution received from FS2.

(2) Excess asset basis. The amount of excess asset basis is $50x, calculated as the amount by which FP’s inside asset basis ($95x) exceeds the sum of FP’s earnings and profits ($40x), the aggregate basis in the outstanding stock of FP ($5x), and the amount of liabilities of FP assumed by US Newco in the F reorganization ($0).

(3) Deemed distribution of specified earnings. The amount of specified earnings equals $50x, the lesser of the following amounts: $100x, the sum of the earnings and profits of FS1 and FS2; and $50x, the amount of excess asset basis with respect to FP. FP is accordingly treated as receiving a distribution of $50x from FS1. Under paragraph (g)(3) of this section, $15x ($50x x ($30x / $100x)) of FS1’s earnings and profits and $35x ($50x x ($70x / $100x)) of FS2’s earnings and profits are designated as specified earnings. FS2 is treated as distributing $35x to FS1. Under sections 301(c)(1) and 954(c)(6), the $50x deemed distribution from FS2 to FS1 is treated as a dividend that does not give rise to foreign personal holding company income. FS1 must accordingly increase its earnings and profits described in section 959(c)(3) by $35x to $65x, and FS2 must decrease its earnings and profits described in section 959(c)(3) by the same amount. FS1 is then treated as making a distribution of $50x to FP. Under sections 301(c)(1) and 954(c)(6), the $50x deemed distribution is also treated as a dividend that does not give rise to foreign personal holding company income. FP must accordingly increase its earnings and profits described in section 959(c)(3) by $50x to $90x, and FS1 must decrease its earnings and profits described in section 959(c)(3) by the same amount.

(A) Adjusted all earnings and profits amount attributable to USP’s FP stock. Under paragraph (g)(1) of this section, USP must compute the all
earnings and profits amount attributable to its stock of FP after taking into account the $50x increase to FP’s earnings and profits that resulted from the deemed distribution of specified earnings. Because USP owns 80% of the stock of FP, $40x (calculated as 80% of $50x) of the specified earnings are attributable to USP’s stock of FP and are included in the all earnings and profits amount attributable to USP’s stock of FP. The all earnings and profits amount that USP must include in income as a deemed dividend is therefore $72x ($53x + $40x).

(5) Adjusted all earnings and profits amount attributable to USS’s FP stock. Under paragraph (g)(1) of this section, USS must compute the all earnings and profits amount attributable to its stock of FP after taking into account the $50x increase to FP’s earnings and profits that resulted from the deemed distribution of specified earnings. Because USS owns 20% of the stock of FP, $10x (calculated as 20% of $50x) of the specified earnings are attributable to USS’s stock of FP and are included in the all earnings and profits amount attributable to USS’s stock of FP. The all earnings and profits amount that USS must include in income as a deemed dividend is therefore $18x ($8x + $10x).

(ii) Example 2—(A) Facts. USS, a domestic corporation, owns all of the stock of FP, which in turn owns all of the stock of FS. Both FP and FS are foreign corporations. The all earnings and profits amount with respect to USS’s stock of FP, determined before any adjustments required by paragraph (g) of this section, is $50x. FP has no other earnings and profits other than the $50x that reflect USP’s all earnings and profits amount. FS has $200x of earnings and profits, all of which are earnings and profits described in section 959(c)(2) (PTEP) because those earnings and profits gave rise to an earlier income inclusion under section 951 with respect to USP. Increases in stock basis were made under section 961 by reason of USP’s section 951 inclusion. FP has excess asset basis of $100x as a result of a previous transaction that was undertaken with a principal purpose of creating excess asset basis in which FS provided $100x of property to FP. In a liquidation described in section 332, FP distributes all of its assets to USS and the stock of FP is cancelled (the FP liquidation).

(B) Analysis—(1) All earnings and profits amount. The FP liquidation is subject to section 367(b) and this section. Under paragraph (b)(3) of this section, USS must include in income as a deemed dividend the all earnings and profits amount with respect to its stock of FP. Because there is excess asset basis with respect to FP, USS must compute the all earnings and profits amount attributable to its stock of FP as if FP had received a distribution of specified earnings immediately before the FP liquidation.

(2) Deemed distribution of specified earnings. The amount of specified earnings equals $100x, the lesser of the following amounts: $200x, the earnings and profits of FS; and $100x, the amount of excess asset basis with respect to FP. FS is accordingly treated as making a distribution of $100x to FP. Under sections 301(c)(1) and 959(b), the $100x deemed distribution from FS to FP is treated as a distribution of PTEP that is not included in the gross income of FP for purposes of section 951. The distribution reduces FS’s earnings and profits and PTEP with respect to USP by $100x and increases FP’s earnings and profits and PTEP with respect to USP by $100x. Furthermore, appropriate adjustments are made under section 961 for the distribution of PTEP.

(3) Adjusted all earnings and profits amount attributable to USP’s stock of FP. Under paragraph (g)(1) of this section, USS must compute the all earnings and profits amount attributable to its stock of FP after taking into account the $100x increase to FP’s earnings and profits that resulted from the deemed distribution of specified earnings. Because the deemed distribution consisted entirely of PTEP with respect to USP, the deemed distribution does not affect USP’s all earnings and profits amount of $50x. See §1.367(b)-2(d)(2)(ii). USS must therefore include $50x in income as a deemed dividend under this section. USS must also recognize any foreign currency gain or loss under section 986(c) with respect to the $100x of PTEP of FP. See §1.367(b)-2(d)(2).

(7) Applicability date—(i) In general. Paragraph (g) of this section (other than paragraphs (g)(2)(vii), (g)(3), and (5) of this section) applies to transactions completed on or after December 2, 2016, and to any transactions treated as completed before December 2, 2016, as a result of an entity classification election made under §301.7701-3 of this chapter that is filed on or after December 2, 2016. Paragraphs (g)(2)(vii), (g)(3), and (5) of this section apply to transactions completed on or after October 5, 2023.

(ii) Transactions completed (or elections made) on or after December 2, 2016, and before October 5, 2023. Except as provided in paragraph (g)(7)(ii) of this section, the following definitions (in lieu of the corresponding definitions or in addition to the definitions in paragraph (g)(2) of this section) and rules apply with respect to transactions completed on or after December 2, 2016, and to any transactions treated as completed before December 2, 2016, as a result of an entity classification election made under §301.7701-3 of this chapter that is filed on or after December 2, 2016, but before October 5, 2023:

(A) The term specified earnings means, with respect to the stock of a foreign acquired corporation that is exchanged by an exchanging shareholder, the lesser of the following amounts (but not below zero):

(1) The sum of the earnings and profits (including a deficit) with respect to each foreign subsidiary of the foreign acquired corporation that are attributable under section 1248(c)(2) to the stock of the foreign acquired corporation exchanged (lower-tier earnings). For purposes of the preceding sentence, the modifications described in §1.367(b)-2(d)(2) and (d)(3) (i) apply. Thus, for example, the amount of the earnings and profits of a foreign subsidiary that are attributable to stock of the foreign acquired corporation is determined without regard to whether the foreign subsidiary was a controlled foreign corporation at any time during the five years preceding the inbound nonrecognition transaction.

(2) The product of the excess asset basis of the foreign acquired corporation, multiplied by the exchanging shareholder’s specified percentage.

(3) The amount of gain that would be realized by the exchanging shareholder if, immediately before the inbound nonrecognition transaction, the exchanging shareholder had sold the stock of the foreign acquired corporation for fair market value, reduced by the exchanging shareholder’s all earnings and profits amount (for this purpose, determined without regard to the modifications described in this paragraph (g)) (specified stock gain).

(B) The term specified percentage means, with respect to an exchanging shareholder, a fraction (expressed as a percentage), the numerator of which is the sum of the aggregate of the specified stock gain with respect to all exchanging shareholders to which §1.367(b)-3(b) (3) applies and the aggregate of the gain realized (regardless of whether such gain is recognized) with respect to the stock exchanged by all other exchanging shareholders.

(C) If there is excess asset basis with respect to a foreign acquired corporation, as determined under paragraph (g)(2)(i) of this section, a taxpayer may reduce the excess asset basis to the extent that the excess asset basis is not attributable, directly or indirectly, to property provided by a foreign subsidiary of the foreign acquired corporation. For example, if there was a transfer of property to the foreign acquired corporation described in section 362(e)(2), and the election described in section 362(e)(2)(C) was made to limit the basis in the stock received in the foreign acquired corporation to its fair market value, then, for purposes of determining
excess asset basis, the basis in the stock of the foreign acquiring corporation may be determined without regard to the application of section 362(e)(2).

(iii) Early application. A taxpayer and its related parties (within the meaning of sections 267(b) and 707(b)(1)) may choose to apply paragraphs (g)(1) through (6) of this section to all open taxable years beginning before the date these regulations are filed as final regulations in the Federal Register, provided that the taxpayer and its related parties consistently apply paragraphs (g)(1) through (6) of this section and §1.367(b)-1(c)(4)(ix) for such years.

Par. 6. Section 1.367(b)-4 is amended by:

1. In paragraph (a), adding a sentence after the fifth sentence;

2. In paragraph (a), removing the language “paragraph (g)” in the current sixth sentence and adding in its place the language “paragraph (h)” and removing the language “paragraph (h)” in the current seventh sentence and adding in its place the language “paragraph (i)”; and

3. In paragraph (e)(5) Example 2 (ii) (B), removing the language “paragraph (g)(1)” wherever it appears and adding in its place the language “paragraph (h)(1)”; and

4. In paragraph (f)(3) Example 2 (ii), removing the language “paragraph (g)(1)” wherever it appears and adding in its place the language “paragraph (h)(1)”; and

5. Redesignating paragraph (h) as paragraph (i);

6. Redesignating paragraph (g) as paragraph (h) and adding a new paragraph (g);

7. Adding a sentence to the end of newly redesignated paragraph (i); and

8. In newly redesigned paragraph (i), removing the language “paragraph (h)” and adding in its place the language “paragraph (i)”, and removing the language “paragraphs (f) and (g)(5)” and adding in its place the language “paragraphs (f) and (h)(5)”.

The additions read as follows:

§1.367(b)-4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

(a) * * * Paragraph (g) of this section provides rules regarding exchanges that occur pursuant to a transaction described in §1.367(b)-10(a)(1), without regard to the exceptions in §1.367(b)-10(a)(2). * * * * * * * *

(g) Income inclusion and gain recognition in exchanges occurring in connection with certain triangular reorganizations—

(1) Rule. If, in an exchange under section 354 or 356 that occurs in connection with a transaction described in §1.367(b)-10, an exchanging shareholder exchanges stock or securities of a foreign acquired corporation, then, to the extent that the exchanging shareholder receives stock or securities of P acquired by S in exchange for property in the P acquisition, the shareholder must:

(i) Include in income as a deemed dividend the section 1248 amount attributable to the stock that the shareholder exchanges; and

(ii) After taking into account the increase in basis in the stock provided in §1.367(b)-2(c)(3)(ii) resulting from the deemed dividend (if any), recognize all realized gain with respect to the stock or securities that would not otherwise be recognized.

(2) Special rules and definitions. For the purposes of this paragraph (g), an exchanging shareholder is a United States person or foreign person that exchanges stock of a foreign acquired corporation in a prescribed exchange, regardless of whether such United States person is a section 1248 shareholder or such foreign person is a foreign corporation in which a United States person is a section 1248 shareholder or such foreign person is a foreign corporation in which a United States person is a section 1248 shareholders. As used in this paragraph (g), the terms P, S, property, and P acquisition have the meanings provided in §1.367(b)-10(a), and the term foreign person means a person that is not a United States person.

(3) Example. The following example illustrates the rules of this paragraph (g):

(i) Facts. USP, a domestic corporation, owns all of the stock of FP and USS. FP is a foreign corporation that owns all of the stock of FS, a foreign corporation. USS is a domestic corporation that owns all of the stock of FT, a foreign corporation. USS owns 100 shares of stock of FT, which constitutes a single block of stock with a fair market value of $100x, an adjusted basis of $20x, and a section 1248 amount of $50x. FS has earnings and profits of $60x. A dividend from FS to FP would qualify for the exception to foreign personal holding company income under section 954(c)(6). FP issues 100 shares of voting stock with a fair market value of $100x to FS, $40x of which (the 40-percent FP block) is issued in exchange for $40x of newly issued common stock of FS and $60x of which (the 60-percent FP block) is issued in exchange for $60x of cash. FS acquires all of the stock of FT held by USS solely in exchange for the $100x of voting stock of FP (that is, FS exchanges both the 40-percent FP block and the 60-percent FP block) in a triangular reorganization described in section 368(a)(1)(B) (triangular B reorganization).

(ii) Analysis—(A) Application of §1.367(b)-10. The triangular B reorganization is described in §1.367(b)-10, and the $60x of cash constitutes property under §1.367(b)-10(a)(3)(ii). Pursuant to §1.367(b)-10(b)(1), adjustments must be made that have the effect of a distribution of property in the amount of $60x from FS to FP under section 301. The $60x deemed distribution is treated as separate from, and occurring immediately before, FS’s acquisition of the 60-percent FP block used in the triangular B reorganization. The $60x deemed distribution from FS to FP results in §1.367(b)-10(a)(2). * * *

[Continues...]

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under section 367(a)(1) with respect to the 40-percent FT block.

* * * * *

(i) ** Paragraph (g) of this section applies to transactions completed on or after December 2, 2016.

Par. 7. Section 1.367(b)-6 is amended by adding paragraphs (a)(1)(v) and (vi) to read as follows:

§1.367(b)-6 Effective/applicability dates and coordination rules.

(a) ** *

(1) ** *

(v) Section 1.367(b)-2(j)(2) applies to transactions completed on or after October 5, 2023 and to any transactions treated as completed before October 5, 2023 as a result of an entity classification election made under §301.7701-3 of this chapter that is filed on or after October 5, 2023.

(vi) Section 1.367(b)-1(c)(2)(vi), (c)(4)(viii), and (c)(4)(ix) apply to taxable years ending on or after October 5, 2023. However, a taxpayer and its related parties (within the meaning of sections 267(b) and 707(b)(1)) may choose to apply the rules referred to in the preceding sentence to all open taxable years ending before October 5, 2023, provided that the taxpayer and its related parties consistently apply such rules and §1.367(b)-3(g) for such years.

* * * * *

Par. 8. Section 1.367(b)-10 is amended by:

1. Adding two sentences to the end of paragraph (a)(1); and
2. Revising paragraphs (a)(2)(ii) and (iii);
3. Removing the language “and” at the end of paragraph (a)(3)(ii)(A), removing the period at the end of paragraph (a)(3)(ii)(B) and adding the language “; and” in its place;
4. Adding paragraph (a)(3)(ii)(C);
5. Removing paragraph (b)(2);
6. Redesignating paragraphs (b)(3), (4), and (5) as paragraphs (b)(2), (3), and (4), respectively;
7. Revising newly redesignated paragraph (b)(2);
8. Adding two sentences to the end of newly redesignated paragraph (b)(3);
9. In newly redesignated paragraph (b)(4)(ii), removing the sixth sentence, revising the current seventh sentence, and adding two sentences at the end of the paragraph; and
10. Revising paragraphs (c), (d), and (e).

The revisions and additions read as follows:

§1.367(b)-10 Acquisition of parent stock or securities for property in triangular reorganizations.

(a) ** *

(1) ** See §1.367(b)-3(g) for the treatment of certain inbound recognition transactions following transactions described in this section. See §1.367(b)-4(g) for rules applicable to certain exchanging shareholders that exchange stock of T in connection with a transaction described in this section.

(2) ** *

(ii) S is a domestic corporation, P is not a controlled foreign corporation (within the meaning of §1.367(b)-2(a)), P’s stock in S is not a United States real property interest (within the meaning of section 897(c)), and the deemed distribution that would result from the application of this section would not be treated as a dividend under section 301(c)(1) that would be subject to U.S. tax under either section 881 (for example, by reason of an applicable treaty or by reason of an absence of earnings and profits) or section 882; or

(iii) In an exchange under section 354 or 356, one or more U.S. persons exchange stock or securities of T and the amount of gain in the T stock or securities that would otherwise be recognized under section 367(a)(1) is equal to or greater than the sum of the amount of the deemed distribution under this section that would be treated and subject to U.S. tax as a dividend under section 301(c)(1) (or would give rise to an inclusion under section 951(a)(1) or 951A(a) that would be subject to U.S. tax) and the amount of gain in the T stock or securities that would otherwise be recognized in accordance with §1.367(b)-4(g).

(b) ** *

(ii) ** * Pursuant to paragraph (b)(2) of this section, the adjustment described in paragraph (b)(1) of this section is made as if the deemed distribution is a separate transaction occurring immediately before the P acquisition. If P does not control (within the meaning of section 368(c)) S at the time of the P acquisition, the adjustments described in paragraph (b)(1) of this section are made as if the deemed distribution is a separate transaction occurring immediately after P acquires control of S, but before the reorganization.

(3) ** *

Thus, P’s adjustment to the basis in its S stock under §1.358-6 is determined as if P provided the P stock or securities pursuant to the plan of reorganization, notwithstanding that S acquired the P stock or securities in exchange for property in the P acquisition. See also §1.367(b)-13.

(4) ** *

(ii) ** * Pursuant to paragraph (b)(2) of this section, the adjustment described in paragraph (b)(1) of this section is made as if the deemed distribution is a separate transaction occurring immediately before FS’s purchase of the P stock on the open market. * * * US1’s transfer of its FT stock in exchange for P stock is subject to §1.367(b)-4(g). If, contrary to the facts in this paragraph (b)(4), US1 had built-in gain with respect to its FT stock, then such gain would be recognized in accordance with §1.367(b)-4(g).

(c) ** Collateral adjustments. This paragraph provides additional rules that apply by reason of the deemed distribution described in paragraph (b)(1)(iv) of this section. A deemed distribution described in paragraph (b)(1) of this section is treated as occurring for all purposes of the Internal Revenue Code. Thus, for example, the ordering rules of section 301(c) apply to characterize the deemed distribution to P as a dividend from the earnings and profits of S, return of stock basis, or gain from the sale or exchange of property, as the case may be. Furthermore, section...
959 may apply to the deemed distribution if S is a foreign corporation, and sections 881, 882, 897, 1442, or 1445 may apply to the deemed distribution if S is a domestic corporation. Appropriate corresponding adjustments must be made to S’s earnings and profits consistent with the principles of section 312.

(d) Anti-abuse rule—(1) Rule. Appropriate adjustments must be made pursuant to this section if, in connection with a triangular reorganization, a transaction is engaged in with a view to avoid the purpose of this section. For example, if S is created, organized, or funded to avoid the application of this section with respect to the earnings and profits of another corporation, the earnings and profits of S (or any successor corporation) may be deemed to include the earnings and profits of such other corporation (or any successor corporation) for purposes of determining the consequences of the adjustments provided in this section, and appropriate corresponding adjustments may be made to account for the application of this section to the earnings and profits of such other corporation (or any successor corporation). Adjustments may be made under this paragraph (d) whether S is funded before or after a triangular reorganization, and such funding may include capital contributions, loans, and distributions. The following examples illustrate the application of this paragraph (d), the application of which is not limited to the particular situations described in the examples.

(2) Example 1: Deemed increase to S’s earnings and profits—(i) Facts. FP is a foreign corporation that owns all of the stock of USS, a domestic corporation. USS has no assets, liabilities, or earnings and profits. FP issues $10x of voting stock to USS in exchange for $10x of newly issued stock of USS, and FP also issues $90x of stock of FP in exchange for a note issued by USS with a fair market value of $90x (USP note). USS is a domestic corporation that is engaged in with a view to avoid the purpose of this section. For example, if S is created, organized, or funded to avoid the application of this section with respect to the earnings and profits of another corporation, the earnings and profits of S (or any successor corporation) may be deemed to include the earnings and profits of such other corporation (or any successor corporation) for purposes of determining the consequences of the adjustments provided in this section, and appropriate corresponding adjustments may be made to account for the application of this section to the earnings and profits of such other corporation (or any successor corporation). Adjustments may be made under this paragraph (d) whether S is funded before or after a triangular reorganization, and such funding may include capital contributions, loans, and distributions. The following examples illustrate the application of this paragraph (d), the application of which is not limited to the particular situations described in the examples.

(ii) Analysis. Because FP’s purchase of the stock of USS is engaged in with a view to avoid the purpose of this section, the anti-abuse rule applies and appropriate adjustments are made. In particular, for purposes of determining the consequences of the deemed distribution provided for in paragraph (b)(3) of this section, the earnings and profits of USS are deemed to include the earnings and profits of FP. USS is therefore treated as having made a deemed distribution equal to $90x, which reflects the portion of the stock of FP that USS acquired in exchange for property (the USP note). Because FP is deemed to have $100x of earnings and profits, the entire $90x deemed distribution is treated as a dividend under section 301(c)(1). The deemed distribution is treated as separate from, and occurring immediately before, USP’s acquisition of the stock of FP used in the triangular B reorganization. No adjustments are made by FP to the basis in its stock of USS except as provided in §1.358-6. Under paragraph (b)(3) of this section, USS’s transfer of the UST note to the basis for its FS2 Newco stock under §1.367(b)-13 is determined as if USP Newco provided the stock of USS Newco stock pursuant to the plan of reorganization.

(3) Example 2: Downstream property transfer—(i) Facts. USP is a domestic corporation that owns all of the stock of FP, a foreign corporation, and USS, a domestic corporation. USS has $100x of earnings and profits. USP has held its stock in FP for fewer than 365 days and thus does not satisfy the requirements of sections 245A and 246(c) with respect to dividends received from FP. USP transfers a note issued by FP with a fair market value of $100x (FS note) to FP in exchange for $100x of voting stock of FP, and FP then uses the stock of FP to acquire all of the stock of UST held by USS in a triangular reorganization described in section 368(a)(1)(B) (triangular B reorganization). Because a dividend from FP to USP would not constitute foreign personal holding company income, the anti-abuse rule applies and appropriate adjustments are made. USP is therefore treated as having made a contribution to USP’s basis in its stock of FP used in the triangular B reorganization. Because USP has more than $100x of earnings and profits, the entire deemed distribution is determined as if USP Newco held all of the stock of USS Newco stock pursuant to the plan of reorganization.

(ii) Analysis. Because the transfers of the USP note are in connection with a triangular reorganization, they are engaged in with a view to avoid the purpose of this section, the anti-abuse rule applies and appropriate adjustments are made. USP is therefore treated as having made a contribution to USP’s basis in its stock of FP used in the triangular B reorganization. Because USP has more than $100x of earnings and profits, the entire deemed distribution is determined as if USP Newco held all of the stock of USS Newco stock pursuant to the plan of reorganization.

(iii) Example 3: Taxable debt exchange—(i) Facts. USS is a domestic corporation that owns all of the stock of FS, a foreign corporation, and USP, a domestic corporation. USS has more than $100x of earnings and profits. USS has held its stock in FS for fewer than 365 days and thus does not satisfy the requirements of sections 245A and 246(c) with respect to dividends received from FS. USS transfers a note issued by FS with a fair market value of $100x (FS note) to FS in exchange for $100x of voting stock of FS, and FS then uses the stock of FS to acquire all of the stock of USS held by USS in a triangular reorganization described in section 368(a)(1)(B) (triangular B reorganization). Because a dividend from FS to USS would not constitute foreign personal holding company income, the anti-abuse rule applies and appropriate adjustments are made. USP is therefore treated as having made a contribution to USP’s basis in its stock of FS used in the triangular B reorganization. Because USP has more than $100x of earnings and profits, the entire deemed distribution is determined as if USP Newco held all of the stock of USS Newco stock pursuant to the plan of reorganization.
Par. 4. Section 1.367(b)-2(e)(3)(ii) by reason of paragraph (a)(2)(iii) of this section is made applicable to:

(a) §1.1411-10 Controlled foreign corporations and passive foreign investment companies.

(b) * * *

(c) * * *

(3) Application of sections 1248 and 367(b). * * *

(i) In determining the amount of gain recognized on the sale or exchange of stock of a foreign corporation under section 1248(a) or the amount of gain realized on the exchange of stock of a foreign corporation under §1.367(b)-4 or 1.367(b)-5, basis is determined in accordance with the provisions of paragraph (d) of this section; and (ii) Section 1248(a), and §1.367(b)-2(c)(1) and (d)(2)(ii) apply without regard to the exclusions for certain earnings and profits under section 1248(d)(1) and (d)(6), except that those exclusions will apply with respect to the earnings and profits of a foreign corporation that are attributable to:

(d) * * *

(5) Basis adjustments under section 367(b). With respect to stock of a foreign corporation that is exchanged in a transaction subject to section 367(b), the portion of the basis increase provided by §1.367(b)-2(e)(3)(ii) by reason of paragraph (c)(3)(ii) of this section is made solely for purposes of section 1411.

* * * * *
Notice of Proposed Rulemaking

Modernizing Regulations on Sales of Seized Property

REG-127391-16

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to modernize regulations regarding the sale of a taxpayer’s property that the IRS seizes by levy. The proposed amendments would allow the IRS to maximize sale proceeds for the benefit of the taxpayer whose property the IRS has seized and the public fisc. The proposed regulations would affect all sales of property the IRS seizes by levy.

DATES: Electronic or written comments and requests for a public hearing must be received by December 15, 2023.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-127391-16). Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish any comments submitted electronically, and on paper, to the public docket. Paper submissions may be sent to: CC:PA:LPD:PR (REG-127391-16), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Micah A. Levy, (202) 317-6832; concerning the submission of comments or requests for a public hearing, Vivian Hayes (202) 317-6901 (not toll-free numbers) or by sending an email to publichearings@irs.gov.

SUPPLEMENTARY INFORMATION:

I. Statutory Background


Section 6335(a) requires the Secretary of the Treasury or her delegate (Secretary), as soon as practicable after a seizure, to give written notice of the seizure to the owner of the property that was seized (or, in the case of personal property, to the property’s possessor). The notice must specify the sum demanded and contain, in the case of personal property, an account of the property seized and, in the case of real property, a description with reasonable certainty of the seized property. Notice must be given to the owner (or possessor) either in person, by leaving it at the owner’s (or possessor’s) usual place of abode or business, or, in certain instances, by mail.

Section 6335(b) requires the Secretary, as soon as practicable after a seizure, to give the property’s owner written notice of the forthcoming sale. The notice must be provided in the same manner prescribed in section 6335(a) for the notice of seizure. Section 6335(b) also requires that the Secretary publicize the sale to the general public by publishing notice “in some newspaper published or generally circulated within the county wherein such seizure is made,” or if such a newspaper does not exist, by posting “notice at the post office nearest the place where the seizure is made and in not less than two other public places.” The notice of sale must specify the property to be sold and the time, place, manner, and conditions of the sale.

Section 6335(c) provides that if seized property is not divisible in a way that would allow for a sale of part of the property to fully satisfy the whole amount of the tax and expenses, the Secretary is to sell the whole property.

Section 6335(d) requires that the time of sale be not less than 10 days nor more than 40 days from the time public notice of the sale is provided under section 6335(b). The place of sale must be within the county in which the property is seized except by special order of the Secretary.

Section 6335(e) specifies the manner and conditions of sale. Section 6335(e) (1) provides general rules about determinations relating to the minimum price, a sale being made to the highest bidder at or above the minimum price, the instances in which property will be deemed sold to the United States at the minimum price, and the instances in which the property will be released to the owner. Section 6335(e)(2) further directs the Secretary to prescribe by regulation the following additional rules applicable to the manner and other conditions of sale: requiring the sale not to be conducted in any manner other than by public auction or by public sale under sealed bids; in the case of the seizure of several items of property whether the property is to be offered separately, in groups, or in the aggregate, and sold under whichever method produces the highest aggregate amount; whether the announcement of the minimum price may be delayed until the receipt of the highest bid; whether payment in full is to be required at the time of acceptance of a bid or whether a part of such payment may be deferred for a period not to exceed one month; the extent to which additional methods (including advertising) may be used in giving notice of a sale; and under what circumstances the Secretary may adjourn a sale from time to time not to exceed in all one month. Congress delegated this authority to allow the IRS “latitude to provide modern rules for selling property in the best manner possible.” H.R. Rep. No. 83-1337, at 410 (1954); S. Rep. No. 83-1622, at 578 (1954). Section 6335(e)(3) specifies what is to occur if a winning bidder fails to pay the bid amount.

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Section 6335(f) provides that the owner of seized property may request the Secretary to sell the property within 60 days after such request (or within a longer period as may be specified by the owner). The Secretary must comply with the request unless the Secretary determines (and thereafter notifies the owner within the period) that doing so would not be in the best interests of the United States.

II. Regulatory Background

The current regulations implementing section 6335 are set forth in §301.6335-1. Section 301.6335-1, which dates to 1954, has not been revised except to incorporate minor statutory changes. See T.D. 6119, 20 FR 28 (Jan. 4, 1955) (initial publication); T.D. 7180, 37 FR 7316 (Apr. 13, 1972) (amending §301.6335-1(b) to conform to an amendment to section 6335(b) made by section 104(d) of the Federal Tax Lien Act of 1966, Public Law 89-719, 80 Stat. 1137 (1966), by expanding notice of sale publication to include newspapers that are “generally circulated” within the county); T.D. 8398, 57 FR 7545 (Mar. 9, 1992) (implementing section 6236(g) of Technical and Miscellaneous Revenue Act of 1988, Public Law 100-647, 102 Stat. 3342 (1988), which enacted section 6335(f), by adding §301.6335-1(d) to address the right of the owner of any seized property to request sale within 60 days); T.D. 8691, 61 FR 66217 (Dec. 17, 1996) (revisions to reflect amendment of section 301.6335(e) concerning the setting of a minimum price for seized property made by section 1570 of the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2764 (1986)); and T.D. 8939, 66 FR 2821 (Jan. 12, 2001) (adding a cross-reference in §301.6335-1(b) to §301.6212-2 regarding the definition of “last known address”). Some provisions of §301.6335-1 are dated, while others do not accommodate technological advances such as the advent of the Internet and electronic payment processing. These proposed amendments would conform the prescribed manner and conditions of sales of seized property with modern practices. In comparison to the existing procedures, the proposed amendments would benefit taxpayers by making the sales process both more efficient and more likely to produce higher sales prices.

Explanation of Provisions

A. Place of Sale

Section 6335(d) of the Internal Revenue Code (Code) requires that the place of sale be “within the county” in which the seizure of the subject property took place, “except by special order of the Secretary.” Section 301.6335-1(c)(1) currently requires that the place of sale be within the county in which the seizure took place unless “substantially higher bids” can be obtained by holding the sale elsewhere, in which case the district director may order that the sale be held in that other place. Section 6335(d) and current §301.6335-1(c)(1) do not expressly contemplate online sales. But online sales can attract a wider range of potential purchasers, and thus potentially higher bids, while conserving IRS resources. Given that section 6342(a) of the Code provides that money realized by the sale of seized property is applied against the expenses of the levy and sale before any remaining amount is made available to satisfy the liability of the taxpayer, taxpayers whose seized property is being sold benefit both when the IRS realizes more money from a sale and when the IRS incurs less expense in conducting the sale.

Proposed §301.6335-1(d)(1) would provide that the sale will be held at the time and place stated in the notice of sale. Proposed §301.6335-1(d)(1) would further provide that the place of an in-person sale must be within the county in which the property is seized, except the sale may be held in a different county if the IRS determines, by special order, that substantially higher bids may be obtained by holding the sale in that different county. For online sales, proposed §301.6335-1(d)(1) would provide that the place of sale will generally be within the county in which the property is seized such that a special order is not needed. For example, under the IRS’s current practice for online sales (which uses the special-order process), bids are solicited from in-county bidders, there is in-county advertising, the property is stored in the county, inspection of the property (when permitted) occurs in the county, and the winning bidder must retrieve the property from within the county. Under the proposed regulations, the place of sale for such online sales would be considered to be within the county in which the property was seized, and no special order would be needed. However, in the unusual situation in which an online sale deviates from current practice, such as if the seized property is moved out of the county for storage and remains out of the county during any allowable period for pre-sale inspection or if the Internet is not generally available within the county, then proposed §301.6335-1(d)(1) would require that such sale may be conducted on the Internet only by special order when doing so would be more efficient or would likely result in more competitive bids.

B. Offering of Property

In the case of the seizure of several items of property, section 6335(e)(2)(B) of the Code allows the IRS to choose how to group the property for sale. In general, the property may be sold as separate items, as groups of items, or in the aggregate. Section 6335(e)(2)(B) of the Code also permits the IRS to offer property both separately (or in groups) and in the aggregate during the same sale, provided that the IRS sells the property “under whichever method produces the highest aggregate amount.”

Section 301.6335-1(c)(5) currently restricts the situations in which both real and personal property may be grouped. This limits the IRS’s ability to determine on a case-by-case basis how to group property to produce the highest sale price. Proposed §301.6335-1(d)(5) would provide that the IRS will choose the method of grouping property (or selling items separately) that will likely produce that highest overall sale amount and is most feasible.

C. Terms of Payment

Section 6335(e)(2)(D) of the Code states that regulations are to provide whether payment in full is required at the time of acceptance of the bid, or whether a part of such payment may be deferred for a period, not to exceed one month, as may be determined by the Secretary to be appropriate. In section 301.6335-1, paragraphs (e)(5)(iv) and (c)(7) are proposed to be amended to allow for payment terms
under §301.6335-1(c)(6)(ii) are proposed to be revised (and redesignated as provisions under §301.6335-1(d)(6)) as follows to apply to all sales under section 6335 of the Code.

1. Form for Use by Bidders

Section 301.6335-1(c)(6)(ii) currently requires that bidders use the form provided by the IRS upon the bidder’s request. The provision, which is proposed to be redesignated §301.6335-1(d)(6)(ii), is proposed to be amended to provide that the bidder should use the form or submission method specified in the notice of sale or in instructions referenced by the notice. For example, the notice of sale may direct bidders to a specific website for the form or method of bid submission.

2. Remittance and Payment Methods

In section 301.6335-1, paragraphs (c)(6)(ii)(c) and (c)(7) currently specify how bid remittances and payments of bid prices are to be made. Those sections require that remittances and payments be made by check or money order. This requirement precludes other commercially acceptable payment options—such as electronic payments, credit or debit card payments, or any other commercially acceptable means authorized by the IRS—even though section 6335 of the Code does not limit the methods by which bidders can make remittances or pay the bid price. Section 301.6335-1(c)(6)(ii)(c), which is proposed to be redesignated §301.6335-1(d)(6)(iii), and §301.6335-1(c)(7), which is proposed to be redesignated §301.6335-1(d)(7), are thus proposed to be amended to provide that remittances and payments are to be made in the manner specified in the notice of sale or in instructions referenced by the notice. For example, the public notice of sale or its instructions could specify that all remittances or payments for a particular sale must be made by check, credit or debit card, or a particular form of electronic payment.

3. Amount of Remittance with Bid

Section 301.6335-1(c)(6)(ii)(c) currently specifies the amount of money a bidder must remit with a sealed bid. Under that section, if the total bid is $200 or less, then the bidder must remit the full amount and, if the total bid is more than $200, then the bidder must remit the greater of $200 or 20 percent of the bid.

Section 6335 of the Code does not specify any amount that must be remitted with a bid except where full payment is required. Additionally, as previously stated, the amounts currently required by §301.6335-1(c)(6)(ii)(c) have never been updated. To give the IRS flexibility to set the terms for bidding, §301.6335-1(c)(6)(ii)(c), which is proposed to be redesignated §301.6335-1(d)(6)(iii), is proposed to be amended by removing the specific $200 threshold. This provision is proposed to provide that the public notice of sale, or instructions referenced in the notice, will specify the amount, if any, required as a remittance with a bid.

4. Method of Submitting and Withdrawing Bids

Section 301.6335-1(c)(6)(ii)(d) specifies the manner for submitting sealed bids. The provision requires that sealed bids be submitted in a sealed envelope. That requirement precludes electronic submission of sealed bids. The provision also does not address how bidders in a public auction should submit bids. The provision, which is proposed to be redesignated §301.6335-1(d)(6)(iv), is proposed to provide that bids for a particular sale—whether public auction or public sale under sealed bids and whether online or not—be submitted in the manner prescribed by the IRS in the notice of sale or in instructions referenced by the notice.

Section 301.6335-1(c)(6)(ii)(f) specifies that sealed bids may be withdrawn in writing or by telegraphic request before the time fixed for the opening of bids. To permit electronic bid withdrawals, the provision, which is proposed to be redesignated §301.6335-1(d)(6)(vi), is proposed to be amended to provide that bid withdrawals may be made in any manner that is specified in the notice of sale or in instructions referenced by the notice.

5. Consideration of Bids

Section 301.6335-1(c)(6)(ii)(e) currently provides that if, at a public sale
under sealed bids, there is a tie amongst bids for the highest amount the IRS will determine the successful bidder by drawing lots. The provision, which is proposed to be redesignated §301.6335-1(d)(6)(v), is proposed to be amended to provide that the IRS will reopen the bidding until a highest bid is submitted without any ties. This change is consistent with the IRS’s current practice.

E. Personnel Involved in Sale

Section 3443 of the Internal Revenue Service Restructuring and Reform Act (Act), Public Law No. 105-206, 112 Stat. 685, 762 (1998), requires the IRS to “implement a uniform asset disposal mechanism for sales under section 6335” that “should be designed to remove any participation in such sales by revenue officers.” Section 3443 of the Act does not apply to sales of perishable goods under section 6336 of the Code.

To implement section 3443 of the Act, the IRS created the position of Property Appraisal and Liquidation Specialist (PALS). A PALS conducts sales of property seized under section 6335 of the Code. In doing so, they often receive assistance from other IRS employees in performing certain ministerial activities, such as delivering notices of sale and logging the receipt of sealed bids. Revenue officers have long been called on to assist an assigned PALS with those ministerial activities.

In enacting section 3443 of the Act, Congress sought to address a lack of uniformity and fairness in the sales process, such as that caused by potential bias of the revenue officer who seized the property to be sold. In the Conference Report to the Restructuring and Reform Act, the conference recognized that tax sales were “often conducted by the revenue officer charged with collecting the tax liability.” H.R. Rep. No. 105-559, at 284 (1998). Additionally, the Senate Report accompanying the Restructuring and Reform Act stated that the Finance Committee “believes that it is important for fairness and the appearance of propriety that the revenue officers charged with collecting unpaid tax liability are not personally involved with the sale of seized property.” S. Rep. No. 105-174, at 85 (1998). Those statements reflect the concern that the revenue officer who seized the property does not participate in the property’s sale.

New proposed §301.6335-1(d)(11) would address that concern by precluding any revenue officer who participated in the seizure of the property to be sold from participating in the sale. This proposed amendment is intended to provide clarity to the IRS in making decisions about which employees will be assigned to conduct sales or perform related ministerial duties and that the restriction on participation in sales does not apply to sales of perishable goods conducted under section 6336 of the Code.

F. Other Changes

This proposed regulation would also make non-substantive updates throughout §301.6335-1. First, current §301.6335-1(a) is proposed to be redesignated and divided into two paragraphs, §301.6335-1(b)(1) and (2). Second, current §301.6335-1(a) and (b)(1) use the term “internal revenue district.” The usage matches that in sections 6335(a) and (b) of the Code. But changes to the IRS’s organizational structure following the Internal Revenue Service Restructuring and Reform Act eliminated “internal revenue districts.” See section 1001(a), 112 Stat. at 689; Grunsted v. Commissioner, 136 T.C. 455, 461 (2011). The current analogous successor to an internal revenue district is a field collection territory. See I.R.M. 1.1.16.3.1.1.1 (June 1, 2016); I.R.M. 5.10.3.9 (May 23, 2016); I.R.M. 5.10.4.9 (Aug. 29, 2017). Proposed §301.6335-1(b)(1) would thus provide that the term “internal revenue district” includes a field collection territory or other successor IRS subdivision or office.

Third, where the current regulation refers to various job titles within the IRS, some of which no longer exist, the references have been replaced with more general references to territories or to the IRS or to its employees. Fourth, where the current regulation, in §301.6335-1(a) and (b), refers to giving a notice of seizure or sale to an individual (in their role as owner or possessor), the references are proposed to be replaced with references to the owner or possessor because an entity could also be an owner or possessor. Fifth, this proposed regulation would also eliminate §301.6335-1(c)(3)(ii) and (c)(4)(iv), which deal with effective dates of the current regulation for sales made after December 17, 1996. Since all sales going forward will occur after that date, those provisions are no longer necessary. Sixth, some four-level headings in the current regulation have differing capitalization in their numbering. Compare §301.6335-1(c)(3)(ii)(a) and (d)(2)(ii)(A). This proposed regulation would align the capitalization of those headings by, for example, redesignating §301.6335-1(c)(3)(ii)(a) as §301.6335-1(d)(3)(ii)(A) and §301.6335-1(c)(5)(ii)(a) as §301.6335-1(d)(5)(ii)(A). And seventh, cross-references to entries that are proposed to be redesignated would be revised to match the redesignations.

Proposed Applicability Date

The proposed rules are proposed to apply to sales of property seized on or after the date of publication of the Treasury decision adopting the proposed rules as final regulations in the Federal Register.

Special Analyses

I. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6(b) of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Regulatory Flexibility Act

It is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). This certification is based on the fact that the proposed regulations solely conform the prescribed manner and conditions of sales of seized property with modern practices. In comparison to the existing procedures, the proposed regulations benefit taxpayers by making the sales process both
more efficient and more likely to produce higher sales prices.

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

III. Unfunded Mandates Reform Act

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

IV. Executive Order 13132: Federalism

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

Comments and Requests for Public Hearing

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

Drafting Information

The principal author of this regulation is Micah A. Levy, Office of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the IRS and Treasury Department participated in the development of this regulation.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 301 as follows:

Part 301—PROCEDURE AND ADMINISTRATION

1. The authority citation for part 301 continues to read in part as follows: Authority: 26 U.S.C. 7805.
2. Amend §301.6335-1 by:
   a. Redesignating paragraphs (a) through (d) as paragraphs (b) through (e), respectively.
   b. Adding a new paragraph (a);
   c. Revising newly designated paragraphs (b) and (c)(1) and (2);
   d. Adding a subject heading to newly redesignated paragraph (c)(3);
   e. Revising newly redesignated paragraphs (d)(1) and (2) and (d)(3)(i) and (ii);
   f. Removing newly redesignated paragraph (d)(3)(iii);
   g. Revising newly redesignated paragraph (d)(4)(iii);
   h. Removing newly redesignated paragraph (d)(4)(iv);
   i. Revising newly redesignated paragraphs (d)(5)(i), (ii), and (iv), (d)(6), (7), and (9);
   j. Adding paragraph (d)(11);
   k. Revising newly redesignated paragraphs (e)(1) and (3); and
   l. Adding paragraph (f).

The revisions and addition read as follows:

§301.6335-1 Sale of seized property.

(a) In general. Section 6335 of the Internal Revenue Code (Code) and this section provide the rules under which the Internal Revenue Service (IRS) conducts sales of property seized by levy.
(b) Notice of seizure—(1) Issuance and delivery. As soon as practicable after seizure of property, the IRS must give written notice to the property’s owner (or, in the case of personal property, to the property’s possessor). The written notice must be delivered to the owner (or to the possessor, in the case of personal property) or left at the owner’s usual place of abode or business if there is such within the internal revenue district in which the seizure is made. If the owner cannot be readily located or has no dwelling or place of business within such district, the notice may be mailed to the owner’s last known address. For purposes of this section, the term internal revenue district means an internal revenue district within the meaning of section 7621 of the Code and includes an IRS field collection territory or other successor IRS subdivision or office.
(2) Contents. The notice of seizure must specify the sum demanded and contain, in the case of personal property, a list sufficient to identify the property seized and, in the case of real property, a description with reasonable certainty of the property seized.
   (c) ** **
(1) In general. As soon as practicable after seizure of the property, the IRS must give notice of sale in writing to the owner. Such notice will be delivered to the owner or left at the owner’s usual place of abode or business if located within the internal revenue district in which the seizure is made. If the owner cannot be readily located or has no dwelling or place of business within such district, the notice may be mailed to the owner’s last known address. For further guidance regarding the definition of last known address, see §301.6212–2. The notice must specify the property to be sold, and the time, place, manner, and conditions of the sale thereof, and must expressly state that only the right, title, and interest of the delinquent taxpayer in and to such property is to be offered for sale. The notice will also be published in some newspaper published in the county wherein the seizure is made or in a newspaper generally circulated in that county. For example, if a newspaper of general circulation in a county but not published in that county will reach more potential bidders for the property to be sold than a newspaper published within the county, or if there is a newspaper of general circulation within the county but no newspaper published within the county, the IRS may publish the notice of sale in the newspaper of general circulation within the county. If there is no newspaper published or generally circulated in the county, the notice will be posted at the post office nearest the place where the seizure is made, to the extent authorized under law, and in not less than two other public places.

(2) Alternative methods. The IRS may use other methods of giving notice of sale and of advertising seized property, in addition to those referred to in paragraph (c)(1) of this section, if the IRS believes that the nature of the seized property to be sold is such that a wider or more specialized advertising coverage will enhance the possibility of obtaining a higher price for the seized property.

(3) Exception. ** * *

(d) ** * *

(1) Time and place of sale. The sale will be held at the time and place stated in the notice of sale. The time of sale will not be less than ten days nor more than 40 days from the time of giving public notice under section 6335(b) of the Code and paragraph (c) of this section. The place of an in-person sale will be within the county in which the property is seized, except such sale may be held at a place outside that county if the IRS determines, by special order of a delegated official, that substantially higher bids may be obtained for the property by holding the sale in such other county. The place of an online sale will generally be the county in which the property is seized. If, based on the facts and circumstances, the IRS determines that the place of an online sale is not within the county in which the property is seized, the sale may be conducted online by special order when doing so would be more efficient or would likely result in more competitive bids.

(2) Adjournment of sale. When it appears that an adjournment of the sale will best serve the interest of the United States or that of the taxpayer, the IRS may adjourn the sale from time to time, but the date of the sale will not be later than one month after the date fixed in the original notice of sale.

(i) Minimum price. Before the sale of property seized by levy, the IRS will determine a minimum price, taking into account the expenses of levy and sale, for which the property must be sold. The IRS will either announce the minimum price before the sale begins or defer announcement of the minimum price until after the receipt of the highest bid, in which case, if the highest bid is greater than the minimum price, no announcement of the minimum price will be made.

(ii) Purchase by the United States. Before the sale of seized property, the IRS will determine whether the purchase of the property by the United States at the minimum price would be in the best interest of the United States. In determining whether the purchase of the property would be in the best interest of the United States, the IRS may consider all relevant facts and circumstances including, for example—

(A) Marketability of property;
(B) Cost of maintaining the property;
(C) Cost of repairing or restoring the property;
(D) Cost of transporting the property;
(E) Cost of safeguarding the property;
(F) Cost of potential toxic waste cleanup; and
(G) Other factors pertinent to the type of property.

(iii) Release to owner. If the property is not declared to be sold under paragraph (d)(4)(i) or (ii) of this section, the property will be released to the owner of the property and the expense of the levy and sale will be added to the amount of tax for the collection of which the United States made the levy. Any property released under this paragraph (d)(4)(iii) will remain subject to any lien imposed by subchapter C of chapter 64 of subtitle F of the Code.

(iv) Terms of payment. The property will be offered for sale in accordance with whichever of the following terms is fixed by the IRS in the public notice of sale:

(A) Payment in full upon acceptance of the highest bid, or
(B) An initial payment upon acceptance of the highest bid if the payment is in the amount (either the dollar amount or the percentage of the purchase price) specified in the notice of sale and followed by payment of the balance (including all costs incurred for the protection or preservation of the property subsequent to the

Exception. ** * *

(A) Marketability of property;
(B) Cost of maintaining the property;
(C) Cost of repairing or restoring the property;
(D) Cost of transporting the property;
(E) Cost of safeguarding the property;
sale and prior to final payment) within a specified period, not to exceed one month from the date of the sale.

(6) Method of sale and sale procedures. The IRS will sell the property either at a public auction (at which open competitive bids will be received) or at a public sale under sealed bids.

(i) Invitation to bidders. Bids will be solicited through a public notice of sale.

(ii) Form for use by bidders. A bid must be submitted in the manner specified by the IRS in the notice of sale or in instructions referenced by that notice.

(iii) Remittance with bid. The notice of sale, or instructions referenced in the notice, will specify the initial payment amount, acceptable forms of the remittance (such as check, credit or debit card, electronic payment, or other means), and the address (physical or online) at which the bid and remittance must be submitted.

(iv) Time for receiving bids. A bid will not be considered unless it is received in the manner and before the time specified in the notice of sale, instructions referenced in the notice, or in the announcement of the adjournment of the sale.

(v) Consideration of bids. The public notice of sale will specify whether the property is to be sold separately, by groups, or in the aggregate, or by a combination of these methods, as provided in paragraph (d)(5)(ii) of this section. If the notice, or instructions referenced in the notice, specifies an alternative method, bidders may submit bids under one or more of the alternatives. In case of error in computing the total price of a group of property in any bid, the unit price of each piece of property will control. The IRS has the right to waive any technical defects in a bid. A technical defect in a bid is deemed waived if the IRS treats it as the winning bid. In the event two or more highest bids are equal in amount, the IRS will reopen the bidding until a high bid is submitted without any ties. After the opening, examination, and consideration of all bids, the IRS will announce the amount of the highest bid or bids and the name of the successful bidder or bidders. Any remittance submitted in connection with an unsuccessful bid will be returned at the conclusion of the sale.

(vi) Withdrawal of bids. A bid may be withdrawn only in the manner specified in the notice of sale or in instructions referenced in the notice. A technical defect in a bid confers no right on the bidder for the withdrawal of the bid after it has been opened or accepted.

(7) Payment of bid price. All payments for property sold under this section must be made in the form and manner (whether by check, credit or debit card, electronic payment, or other means) specified by the IRS in the public notice of sale or in instructions referenced in the notice. If payment in full is required upon acceptance of the highest bid, the payment must be made at the time and in accordance with the terms specified in the notice of sale. If deferred payment is permitted, the initial payment must be made upon acceptance of the bid at the time and in accordance with the terms specified in the notice of sale, and the balance must be paid on or before the date fixed for payment thereof. Any remittance submitted with a successful bid will be applied toward the purchase price.

(9) Default in payment. If payment in full is required upon acceptance of the bid and is not paid when due, the IRS will proceed again to sell the property in the manner provided in section 6335(e) of the Code and this section. If the conditions of the sale permit part of the payment to be deferred, and if such part is not paid within the prescribed period, suit may be instituted against the purchaser for the purchase price or such part thereof as has not been paid, together with interest at the rate of six percent per annum from the date of the sale; or, in the discretion of the IRS, the sale may be declared null and void for failure to make full payment of the purchase price and the property may again be advertised and sold as provided in subsections (b), (c), and (e) of section 6335 of the Code and this section. In the event of such readvertisement and sale, any new purchaser will receive such property or rights to property free and clear of any claim or right of the former defaulting purchaser, of any nature whatsoever, and the amount paid upon the bid price by such defaulting purchaser will be forfeited to the United States.

(11) Participation in sale by revenue officers. No revenue officer who seized the property to be sold at a sale conducted under section 6335 of the Code and this section may participate in the sale of that seized property. This restriction does not apply to sales of perishable goods conducted under section 6336 of the Code.

(12) Applicability date. The rules of this section apply to sales of property seized on or after [DATE OF PUBLICATION].

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

(Filed by the Office of the Federal Register October 13, 2023, 8:45 a.m., and published in the issue of the Federal Register for October 16, 2023, 88 FR 71323)
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.
Cl.—City.
COOP—Cooperative.
Cl.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Det. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
EO—Executive Order.
ER—Employer.

EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
FR—Federal Register.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transfer.
TFR—Transferor.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
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 2023–27 through 2023–52 is in Internal Revenue Bulletin 2023–52, dated December 27, 2023.
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¹A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2023–27 through 2023–52 is in Internal Revenue Bulletin 2023–52, dated December 27, 2023.
INTERNAL REVENUE BULLETIN

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

We Welcome Comments About the Internal Revenue Bulletin

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