INTERNAL REVENUE
BULLETIN

IRS

HIGHLIGHTS OF THIS ISSUE

Bulletin No. 2026–39
September 21, 2026

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, INCOME TAX

T.D. 10054, page 372.

This document contains final regulations regarding the deduction for certain taxpayers for an amount up to $10,000 of qualified passenger vehicle loan interest. This document also contains final regulations regarding new information reporting requirements for certain persons who, in a trade or business, receive from any individual interest aggregating $600 or more for any calendar year on a specified passenger vehicle loan, including applicable penalties for failures to file information returns or furnish payee statements as required. These regulations affect taxpayers that may deduct qualified passenger vehicle loan interest, and also persons subject to these information reporting requirements.

EXEMPT ORGANIZATIONS

Announcement 2026-16, page 413.

Revocation of IRC 501(c)(3) Organizations for failure to meet the code section requirements. Contributions made to the organizations by individual donors are no longer deductible under IRC 170(b)(1)(A).

REG-119986-25, page 440.

This document contains proposed regulations providing that a school cannot qualify for tax-exempt status as a charitable organization under § 501(c)(3) if it maintains racially discriminatory practices or policies. The IRS has taken this position in sub-regulatory guidance for several decades. The proposed rules would further state that racial discrimination is incompatible with charitable tax-exempt status regardless of the purpose behind that discrimination. The proposed regulations would affect tax-exempt private schools, including primary and secondary schools, colleges, universities, and professional or trade schools.

INCOME TAX

REG-115646-25, page 414.

These proposed regulations would provide rules for determining a United States shareholder's pro rata share of subpart F income, tested income, or tested loss of a controlled foreign corporation that reflect amendments made by Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA). The proposed regulations would also modify certain information reporting requirements and the applicability dates of certain related rules. Additionally, the proposed regulations include the rules described in Notice 2025-75 regarding the transition rule contained in section 70354(c)(2) of the OBBBA.

Rev. Proc. 2026-32, page 406.

Revenue Procedure 2026-32 provides procedures under § 446 of the Internal Revenue Code and § 1.446-1(e) for obtaining automatic consent of the Commissioner of Internal Revenue to change methods of accounting for research or experimental expenditures (i) to comply with § 174, as in effect after amendment by § 13206(a) of Public Law 115-97, 131 Stat 2054 (Dec. 22, 2017), commonly known as the Tax Cuts and Jobs Act (TCJA), and prior to amendment by § 70302(b)(1) of Public Law 119-21, 139 Stat. 189, 239 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), and (ii) to comply with §§ 174 and 174A, as amended and enacted by the OBBBA, respectively.

Revenue Procedure 2026-32 also provides procedures under § 446 and § 1.446-1(e) for obtaining automatic consent of the Commissioner to change methods of accounting for contracts entered into in taxable years beginning after July 4, 2025, to comply with § 460(e), as amended by the OBBBA.

Finding Lists begin on page ii.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

Part I

26 CFR 1.163-16: Qualified passenger vehicle loan interest.

T.D. 10054

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Car Loan Interest Deduction

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the deduction for certain taxpayers for an amount up to $10,000 of qualified passenger vehicle loan interest. This document also contains final regulations regarding new information reporting requirements for certain persons who, in a trade or business, receive from any individual interest aggregating $600 or more for any calendar year on a specified passenger vehicle loan, including applicable penalties for failures to file information returns or furnish payee statements as required. These regulations affect taxpayers that may deduct qualified passenger vehicle loan interest, and also persons subject to these information reporting requirements.

DATES: *Effective date*: The final regulations are effective on November 9, 2026.

Applicability date: For dates of applicability, see §§ 1.163-16(i) and 1.6050AA-1(i).

FOR FURTHER INFORMATION CONTACT: Riston Escher of the Office of Associate Chief Counsel (Income Tax & Accounting) at (202) 317-7003 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Authority

This document contains amendments that add new regulations to the Income Tax Regulations (26 CFR part 1) under sections 163 and 6050AA of the Internal Revenue Code (Code), as amended and enacted, respectively, by section 70203(a) and (c)(1) of Public Law 119-21, 139 Stat. 72, 176-179 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), related to the allowance of a Federal income tax deduction under section 163(a) and (h)(4) for qualified passenger vehicle loan interest (QPVLI) and certain information reporting requirements under section 6050AA for persons receiving certain interest on a specified passenger vehicle loan (SPVL). This document also contains amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to electronic filing of returns under section 6011 of the Code, and penalties under section 6721 of the Code for failures to file information returns and under section 6722 of the Code for failures to furnish payee statements.

The regulations are issued under the authority of section 7805(a) of the Code, which authorizes the Secretary of the Treasury or the Secretary's delegate (Secretary) to prescribe all needful rules and regulations for the enforcement of the Code including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue. The regulations under section 6050AA are also issued under the authority of section 6050AA(e), which authorizes the Secretary to issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of section 6050AA, including regulations or other guidance to prevent the duplicate reporting of information under section 6050AA. The regulations under section 6011 are also issued under the authority of section 6011(e), which authorizes the Secretary to prescribe regulations that require taxpayers to electronically file returns, including information returns, if the taxpayer is required to file at least 10 returns of any type during a calendar year.

Background

Section 70203(a) of the OBBBA amended section 163(h) (relating to the disallowance of any deduction for personal interest) by inserting a new paragraph (4) to provide an exception for QPVLI. Section 70203(b) of the OBBBA amended section 63(b) of the Code by inserting a new paragraph (7) to allow this deduction for taxpayers that do not itemize their deductions. Section 70203(c) of the OBBBA added new section 6050AA to the Code to require information returns relating to applicable passenger vehicle loan interest received in a trade or business from individuals. The amendments made by section 70203 of the OBBBA apply to indebtedness incurred after December 31, 2024. The new allowance of a deduction for QPVLI under section 163(a) and (h)(4) applies solely to taxable years beginning after December 31, 2024, and before January 1, 2029. Section 6050AA(f) provides that no information return is required under section 6050AA for any period to which section 163(h)(4) does not apply.

I. *Section 163*

Section 163(a) allows a deduction for all interest paid or accrued within the taxable year on indebtedness. Section 163(h) generally disallows a deduction for personal interest. Section 163(h)(1) provides that a taxpayer other than a corporation cannot take a deduction for personal interest paid or accrued during the taxable year under chapter 1 of the Code (chapter 1). Section 163(h)(2) defines "personal interest" as any interest deductible under chapter 1 other than (a) interest paid or accrued on indebtedness properly allocable to the conduct of a trade or business (other than the trade or business of performing services as an employee), (b) investment interest, (c) interest taken into account under section 469 of the Code in computing income or loss from a passive activity, (d) qualified residence interest, (e) interest payable under section 6601 of the Code on any unpaid portion of the tax imposed by section 2001 of the Code for the period during which an extension of time for payment of such tax is in effect under section 6163 of the Code, and (f) any interest allowable as a deduction under section 221 of the Code.

As added by the OBBBA, new section 163(h)(4)(A) provides that in the case of taxable years beginning after December 31, 2024, and before January 1, 2029, personal interest does not include QPVLI. As a result, a deduction for QPVLI is allowable under section 163(a) for such taxable years. Section 163(h)(4)(B)(i) provides that "qualified passenger vehicle loan interest" means any interest that is paid or accrued during the taxable year on indebtedness incurred by the taxpayer after December 31, 2024, for the purchase of, and that is secured by a first lien on, an applicable passenger vehicle (APV) for personal use, subject to certain enumerated exceptions in section 163(h)(4)(B)(ii). Section 163(h)(4)(C) provides limitations on the amount of QPVLI that a taxpayer can deduct during a taxable year. Section 163(h)(4)(D) defines an "applicable passenger vehicle" as a vehicle that satisfies the requirements of section 163(h)(4)(D)(i) through (vi) but excludes from the definition any vehicle the final assembly of which did not occur within the United States. Section 163(h)(4)(E) provides the definition of "final assembly" and special rules on the treatment of refinancings and related party indebtedness.

II. *Section 63(b)(7)*

Section 63 defines "taxable income" for purposes of subtitle A of the Code (subtitle A). Section 63(a) provides the general rule that, except as provided in section 63(b), for purposes of subtitle A, the term "taxable income" means gross income minus the deductions allowed by chapter 1 (other than the standard deduction). Section 63(b) provides that, in the case of an individual who does not elect to itemize the individual's deductions for the taxable year, for purposes of subtitle A, the term taxable income means "adjusted gross income" (as defined in section 62 of the Code), minus the deductions enumerated in section 63(b)(1) through (7). As amended by the OBBBA, new section 63(b)(7) provides that so much of the deduction allowed by section 163(a) as is attributable to the exception under section 163(h)(4)(A) is subtracted from adjusted gross income in computing taxable income.

III. *Section 6050AA*

Section 6050AA(a) provides that any person engaged in a trade or business who, in the course of that trade or business, receives from any individual interest aggregating $600 or more for any calendar year on an SPVL, must file an information return reporting the receipt of interest. Section 6050AA(b) provides that the information return filed by the recipient of such interest (interest recipient) must be in the form prescribed by the Secretary and must contain: (A) the name and address of the individual from whom such interest was received, (B) the amount of such interest received for the calendar year, (C) the amount of outstanding principal on the SPVL as of the beginning of such calendar year, (D) the date of origination of that loan, (E) the year, make, model, and vehicle identification number (VIN) of the APV that secures that loan (or any other description of that vehicle as the Secretary may prescribe), and (F) any other information as the Secretary may prescribe.

Section 6050AA(c) provides that every person required to make an information return under section 6050AA(a) must also furnish to each individual whose name is required to be included in the return a written statement showing the name, address, and phone number of the interest recipient, and the information required to be included in the information return under section 6050AA(b)(2)(B) through (F).

Section 6050AA(d)(1) provides that terms used in section 6050AA that are also used in section 163(h)(4) have the same meaning as when used in section 163(h)(4). Section 6050AA(d)(2) defines "specified passenger vehicle loan" as the indebtedness described in section 163(h)(4)(B) with respect to any APV.

Section 6050AA(e) authorizes the Secretary to issue regulations or guidance as may be necessary or appropriate to carry out the purposes of section 6050AA, including regulations or other guidance to prevent duplicate reporting.

IV. *Section 6011 and Electronic Filing of Information Returns*

Section 6011(e) authorizes the Secretary to prescribe regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form. Section 6011(e)(5) authorizes the Secretary to prescribe regulations that require taxpayers to electronically file returns, including information returns, if the taxpayer is required to file at least 10 returns of any type during a calendar year.

V. *Penalties Under Sections 6721 and 6722*

Section 6721 imposes a penalty for any failure to file an information return on or before the required filing date, and for any failure to include all the information required to be shown on a return or the inclusion of incorrect information. Section 6722 imposes a penalty for any failure to furnish a payee statement on or before the required furnishing date to the person to whom such statement is required to be furnished and for any failure to include all the information required to be shown on a payee statement or the inclusion of incorrect information.

Section 70203(c)(2)(A) of the OBBBA amended section 6724(d)(1) of the Code to add information reporting requirements under section 6050AA—regarding returns relating to QPVLI received in a trade or business from individuals—to the definition of "information return." Section 70203(c)(2)(B) of the OBBBA similarly amended the definition of "payee statement" in section 6724(d)(2). As a result of these amendments, penalties under sections 6721 and 6722 may be imposed on interest recipients that fail to file correct information returns and payee statements under section 6050AA.

On October 21, 2025, the IRS released Notice 2025-57, 2025-45 I.R.B. 692, to provide transitional guidance on the information reporting requirements under section 6050AA. Notice 2025-57 provides that an interest recipient will be deemed to have satisfied the reporting obligations under section 6050AA for interest on SPVLs received in calendar year 2025 if the interest recipient makes a statement available to the individual indicating the total amount of interest received in calendar year 2025 on an SPVL.

VI. *Notice of Proposed Rulemaking*

On January 2, 2026, the Treasury Department and the IRS published a notice of proposed rulemaking and notice of public hearing (REG-113515-25) in the ***Federal Register*** (91 FR 67) under sections 163, 6050AA, 6011, 6721, and 6722 (proposed regulations). The proposed regulations proposed rules regarding the deduction for certain taxpayers for an amount up to $10,000 of QPVLI. The proposed regulation also proposed rules regarding the new information reporting requirements for certain persons who, in a trade or business, receive from any individual interest aggregating $600 or more for any calendar year on an SPVL, including applicable penalties for failures to file information returns or furnish payee statements as required. The proposed regulations also proposed rules relating to electronic filing of returns under section 6011.

Summary of Comments and Explanation of Revisions

I. *Overview*

The Treasury Department and the IRS received 63 public comments in response to the notice of proposed rulemaking. Copies of the comments are available for public inspection at http://www.regulations.gov or upon request. In addition, a public hearing on the proposed regulations was held on February 24, 2026, at which three speakers provided testimony. After considering all of the public comments, speaker outlines, and testimony (collectively, comments) received in response to the proposed regulations, the Treasury Department and the IRS adopt the proposed regulations, as revised in response to the comments described in this Summary of Comments and Explanation of Revisions, as final regulations.

Comments addressing issues that are outside the scope of this rulemaking are generally not addressed in this Summary of Comments and Explanation of Revisions or adopted in the final regulations. These comments included recommendations and questions regarding implementation issues for other Code provisions and examination selection criteria. Unless otherwise indicated in this Summary of Comments and Explanation of Revisions, provisions of the proposed regulations with respect to which no comments were received are adopted without substantive change.

II. *Comments on Proposed § 1.163-16*

A. *In General*

In response to the comments received, the final regulations include revisions to the following provisions in proposed § 1.163-16: proposed § 1.163-16(b)(12) (*Qualified passenger vehicle loan interest (QPVLI)*) (finalized as § 1.163-16(b)(13)); proposed § 1.163-16(b)(13) (*Qualified vehicle classification*) (finalized as § 1.163-16(b)(14) (*Qualified vehicle type*)); proposed § 1.163-16(b)(14) (*Secured by a first lien*) (finalized as § 1.163-16(b)(15)); proposed § 1.163-16(c)(2) (*Determining the amount of interest paid or accrued during a taxable year*); proposed § 1.163-16(d)(2) (*Indebtedness incurred for the purchase of an APV*); and proposed § 1.163-16(e)(2) (*Determining whether original use commences with the taxpayer*). Additionally, in response to the comments received, the final regulations include the addition of the following new provisions in § 1.163-16: § 1.163-16(b)(6) (*Items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV*); § 1.163-16(d)(6)(v) (*Example 5: Method of allocating interest*); § 1.163-16(e)(2)(ii) (*Dealers*); § 1.163-16(e)(2)(iii) (*Original use for joint purchasers*).

The final regulations also include revisions to § 1.163-16(c)(3)(ii) (*Exception for substitute vehicle due to an unforeseen intervening event*). The revisions to § 1.163-16(c)(3)(ii) are intended to clarify that a substitute APV described in § 1.163-16(c)(3)(ii) is treated as the APV with respect to which the SPVL was incurred for the purposes of § 1.163-16(c)(5) (*VIN requirement*) and § 1.163-16(d)(4) (*Refinancing of an SPVL*).

B. *Definitions*

1. *Secured By A First Lien*

Section 163(h)(4)(B)(i) provides that interest is QPVLI only if it is paid or accrued on indebtedness that is incurred by the taxpayer after December 31, 2024, for the purchase of, and that is secured by a first lien on, an APV for personal use. Proposed § 1.163-16(b)(14) provided that, for purposes of section 163(h)(4) and the proposed regulations, "secured by a first lien" means a valid and enforceable security interest in an APV under State or other applicable law with priority ahead of all other security interests, other than tax liens or other similar security interests that may be given higher priority at a later date following the date of purchase and only in limited circumstances.

One commenter requested that the final regulations provide clarity on whether "first lien" status is determined by the initial filing and attachment of the security interest, regardless of involuntary liens such as mechanic's liens or State tax liens that may cause the earlier lien to be subordinated. The commenter recommended that the final regulations clarify that a loan qualifies as a first lien so long as it was the first voluntary security interest recorded against the vehicle, disregarding involuntary liens (for example, mechanic's liens or State tax liens) that may take temporary legal priority under State or local law.

The Treasury Department and the IRS agree with the commenter that it would be helpful to further clarify the status of a lien that is subordinated by involuntary liens. Accordingly, § 1.163-16(b)(15) provides that "secured by a first lien" means the first voluntary security interest recorded against the vehicle, disregarding any involuntary liens that may be given temporary higher priority at a later date.

One commenter noted that under State law, vehicle lien placement generally relates back to the loan origination date if the lien is perfected within a statutory grace period. In certain cases, however, lien perfection may occur after this grace period, often due to administrative delays in title processing that are outside the lender's control. Accordingly, the commenter recommended that the final regulations clarify that interest accruing from the loan origination date (rather than the lien perfection date) may be QPVLI so long as the contract was originated as a purchase transaction secured by a first lien.

This commenter also noted that there are circumstances in which a vehicle lien is removed before the loan is paid in full, such as in the case of repossession and subsequent sale of the vehicle, or an insurance payment following a total loss claim. Accordingly, the commenter recommended that the final regulations clarify that temporary or permanent lien release events that occur after loan origination do not retroactively or prospectively disqualify a taxpayer from claiming the QPVLI deduction, provided that the vehicle finance contract was originally secured by a first lien on the purchased APV.

The Treasury Department and the IRS generally agree with these comments. Accordingly, § 1.163-16(b)(15) provides that an APV may be considered to be secured by a first lien even in a case in which a lien has not yet been perfected or recorded due to processing times or other similar short-term delays arising under State or other applicable law, and in limited circumstances in which a lien is removed in connection with the taxpayer no longer owning the vehicle but the taxpayer continues to be liable for an SPVL, such as in the case of a repossession of the vehicle or an insurance payout following a total loss claim.

2. *Qualified Vehicle Type*

Section 163(h)(4)(D)(iv) provides that a vehicle is an APV only if it is a car, minivan, van, sport utility vehicle, pickup truck, or motorcycle. Proposed § 1.163-16(b)(13)(ii) through (vii) defined the terms "car," "minivan," "van," "sport utility vehicle," "pickup truck," and "motorcycle" by reference to certain vehicle classifications and definitions used by the Environmental Protection Agency (EPA). Some of these classifications depend on a vehicle's gross vehicle weight rating (GVWR) and one of these definitions depend on a vehicle's curb mass. Further, section 163(h)(4)(D)(vi) requires, and proposed § 1.163-16(e)(1)(vi) provided that for a vehicle to be an APV it must have a GVWR of less than 14,000 pounds.

One commenter noted that the proposed § 1.163-16(b)(13)(v) definition of sport utility vehicle would exclude sport utility vehicles with a GVWR exceeding 10,000 pounds. The commenter also noted that the proposed § 1.163-16(b)(13)(vi) definition of pickup truck would exclude pickup trucks with a GVWR exceeding 8,500 pounds. The commenter requested clarification on how the definitions in proposed § 1.163-16(b)(13)(v) and (vi) would operate together with the 14,000-pound GVWR limitation provided by section 163(h)(4)(D)(vi) and proposed § 1.163-16(e)(1)(vi).

The Treasury Department and the IRS agree with the commenter that the definitions of sport utility vehicle and pickup truck provided in proposed § 1.163-16(b)(13) could cause confusion regarding the treatment of those vehicles that have a GVWR that exceeds the GVWR specified in the applicable definition referenced in proposed § 1.163-16(b)(13), but do not exceed the 14,000-pound GVWR limitation provided by section 163(h)(4)(D)(vi). Further, while the definition of motorcycle referenced in proposed § 1.163-16(b)(13) would exclude motorcycles with a curb mass greater than 1,499 pounds, this weight restriction is not a statutory requirement. Accordingly, § 1.163-16(b)(14) provides broader definitions of sport utility vehicle, pickup truck, and motorcycle that do not reference a GVWR or curb weight limitation for vehicles. Additionally, for clarity and ease of administration, the final regulations define van and minivan by direct reference to the applicable EPA regulation. As under the proposed regulations, these revised definitions operate together with, and do not alter, the separate requirement in section 163(h)(4)(D)(v) that the vehicle be treated as a motor vehicle for purposes of title II of the Clean Air Act.

C. *Qualified Passenger Vehicle Loan Interest (QPVLI)*

Section 163(h)(4)(B)(i) provides and proposed § 1.163-16(d)(1) provided that interest is QPVLI only if it is paid or accrued on indebtedness that is incurred by the taxpayer after December 31, 2024, for the purchase of, and that is secured by a first lien on, an APV for personal use. Proposed § 1.163-16(c) provided, in relevant part, that interest is QPVLI only if the interest is paid or accrued during the taxable year on indebtedness that is an SPVL secured by a first lien on an APV, and is not excluded from the definition of QPVLI.

For purposes of section 163(h)(4), QPVLI includes all interest payable with respect to the amount financed under an SPVL. In general, interest is an amount paid, received, or accrued as compensation for the use or forbearance of money under the terms of an instrument or contractual arrangement that is treated as a debt instrument for Federal income tax purposes or an amount otherwise treated as interest under the Code or Income Tax Regulations. For example, see § 1.163(j)-1(b)(22)(i); see also *Deputy v. DuPont*, 308 U.S. 488, 498 (1940).

Several commenters requested clarification on what constitutes interest for purposes of section 163(h)(4). Specifically, clarification was requested as to the treatment of stated periodic interest, prepaid interest (such as points), origination-related or financing-related charges, prepayment penalties, late payment charges, default-related charges, returned payment fees, and deferred or capitalized interest that is added to the outstanding principal balance in accordance with the terms of the indebtedness. Some commenters mentioned that certain of the fees are specifically referenced in other regulations or guidance relating to the deduction of interest for Federal income tax purposes (for example, see §§ 1.221-1(f) and 1.6050H-1).

The Treasury Department and the IRS agree with the commenters that additional clarification on what constitutes interest is appropriate, including the addition of examples of fees that are interest for purposes of section 163(h)(4). Accordingly, § 1.163-16(c)(2)(i) clarifies that QPVLI includes prepaid interest in the form of points and deferred or capitalized interest. The final regulations also provide that QPVLI includes origination-related or financing-related charges, prepayment penalties, late payment charges, default-related charges, and similar fees, if such charge, penalty, or fee is characterized as interest expense for Federal income tax purposes and is included in the amount reported as interest in the statement furnished to the taxpayer under section 6050AA(c) and § 1.6050AA-1(h). However, to the extent such interest (including prepaid interest in the form of points or deferred or capitalized interest) creates or increases the amount of original issue discount on the SPVL, such amounts generally are not deductible until paid in accordance with the payment ordering rules described in § 1.163-16(c)(2)(ii). See also section 1275(b) of the Code. The payment ordering rules in §§ 1.446-2 and 1.1275-2 determine when interest (including original issue discount) is paid and therefore deductible by the borrower. Similarly, these rules generally apply for information reporting purposes, including section 6050AA.

D. *Specified passenger vehicle loan (SPVL)*

1. *Indebtedness*

Section 163(h)(4)(B)(i) provides and proposed § 1.163-16(d)(1) provided that interest is QPVLI only if it is paid or accrued on indebtedness that is incurred by the taxpayer after December 31, 2024, for the purchase of, and that is secured by a first lien on, an APV for personal use.[1] Proposed § 1.163-16(c) provided, in relevant part, that interest is QPVLI only if the interest is paid or accrued during the taxable year on indebtedness that is an SPVL secured by a first lien on an APV.

a. *Incurring Indebtedness*

Multiple commenters recommended that taxpayers should also be able to deduct QPVLI for vehicle loans incurred prior to December 31, 2024. These commenters noted that section 163(h)(4)(B)(i) excludes taxpayers who took out a loan to purchase a new vehicle in late 2024 but will pay nearly all of the interest on the loan from 2025 through 2028, the years in which QPVLI may be deducted.

Section 163(h)(4)(B)(i) defines "qualified passenger vehicle loan interest" or QPVLI, in relevant part, as interest paid on a loan incurred after December 31, 2024. Therefore, the Treasury Department and the IRS are not able to adopt the commenters' recommendation as doing so would be inconsistent with the plain language of the statute.

One commenter asked how to identify the amount of interest if a vehicle is purchased with a credit card. Section 163(h)(4)(B)(i) requires, in relevant part, that indebtedness be secured by a first lien on an APV. The Treasury Department and the IRS note that generally credit card indebtedness is not secured indebtedness. Therefore, the purchase of an APV, in whole or in part, with a credit card would generally not result in an SPVL and therefore any interest paid or accrued on this credit card indebtedness would not be QPVLI.

b. *Amount of the Indebtedness*

i. *Indebtedness Incurred to Purchase an APV*

Several commenters requested that the Treasury Department and the IRS treat all of the indebtedness incurred in connection with the purchase of an APV as an SPVL, and not require an allocation of the indebtedness between the SPVL portion and the non-SPVL portion as provided in proposed § 1.163-16(d)(2)(iii)(A) because of the compliance burden this allocation approach would impose.

The allocation approach, however, is necessary to ensure compliance with the statutory requirement that only interest "for the purchase" of an APV is deductible under section 163(h)(4). Accordingly, the final regulations maintain the allocation approach.

Proposed § 1.163-16(d)(2)(i) generally provided that indebtedness qualifies as an SPVL only to the extent the indebtedness is incurred for the purchase of an APV and, if part of the same purchase transaction, for any other items or amounts customarily financed in an APV purchase transaction and that are directly related to the purchase of the APV. The preamble to the proposed regulations provided that whether items or amounts are customarily financed in an APV purchase transaction is determined on an industry-wide basis, and not by reference to the financing terms of a particular financing entity. Proposed § 1.163-16(d)(2)(i) provided examples of such "customarily financed" items to include vehicle service plans, extended warranties, sales taxes, and vehicle-related fees. Proposed § 1.163-16(d)(2) provided that any indebtedness that is not described in proposed § 1.163-16(d)(2)(i) would not qualify as an SPVL, even if the items or amounts were incurred as part of a purchase transaction for an APV. Examples of such indebtedness include indebtedness incurred for the repayment of negative equity on a loan secured by a trade-in vehicle, to purchase collision and liability insurance, or to purchase any property or services not directly related to an APV (for example, a trailer or boat).

Several commenters requested that the Treasury Department and the IRS expand the list of examples in proposed § 1.163-16(d)(2)(i) of items that are customarily financed in an APV purchase transaction that are directly related to the purchase of the APV, including such items as vehicle repair plans, mechanical repair coverage, vehicle protection products (including tire, wheel, paint, and interior protection products), warranties, extended warranties, guaranteed asset protection (GAP) insurance, credit-related insurance products (including credit-related accident, health, and life products), key fob replacement, and title and registration fees.

The Treasury Department and the IRS agree with the commenters that expanding the examples of items customarily financed in an APV purchase transaction that are directly related to the purchase of the APV would provide additional clarity. Accordingly, the final regulations expand the list of examples of items customarily financed in an APV purchase transaction that are directly related to the purchase of the APV. Further, the final regulations clarify that the exclusion for collision and liability insurance applies only to collision or liability insurance that is not credit insurance.

One commenter requested that the Treasury Department and the IRS expand the list of examples in proposed § 1.163-16(d)(2)(i) to include vehicle-related accessories as items that are regarded as customarily obtained or paid for as part of an APV purchase transaction. The Treasury Department and the IRS agree that indebtedness attributable to vehicle-related accessories that are components of the APV may be included in an SPVL. Accordingly, the final regulations provide that indebtedness incurred for vehicle-related accessories that are components of

[1] Section 163(h)(4)(B)(i) does not use a specific term for this indebtedness, and the final regulations, like the proposed regulations, refer to such indebtedness as a "specified passenger vehicle loan" or an "SPVL," which is the term used in section 6050AA to reference this indebtedness, for consistency.

the APV purchased as part of an APV transaction may be an SPVL. Additionally, the final regulations now include language adopted from the preamble to the proposed regulations to make clear that whether items or amounts are customarily financed in an APV purchase transaction and are directly related to the purchase of the APV is determined on an industry-wide basis and not by reference to the financing terms of a particular financing entity.

ii. *Negative Equity*

A number of comments received were related to amounts representing debt on a vehicle traded in as part of the purchase transaction for the APV in excess of the value of the vehicle, which is sometimes referred to as "negative equity." Proposed § 1.163-16(d)(2)(ii) provided that indebtedness incurred for amounts representing negative equity under an existing loan on a trade-in vehicle is not incurred by a taxpayer for the purchase of an APV, and therefore is not an SPVL.

Many commenters requested that the Treasury Department and the IRS instead provide that indebtedness incurred for amounts representing negative equity may qualify as an SPVL, especially because the incurrence of indebtedness for amounts representing negative equity occurs regularly for many purchasers.

The Treasury Department and the IRS do not adopt these requests, and the final regulations provide that indebtedness incurred for amounts representing negative equity is not incurred by a taxpayer for the purchase of an APV, and therefore is not an SPVL. Section 163(h)(4)(B)(i) describes indebtedness that is incurred by the taxpayer for the purchase of an APV for personal use. Amounts representing negative equity are not incurred for the purchase of an APV as required by the statute and instead represent indebtedness related to a prior purchased vehicle that is refinanced in connection with the purchase of a new vehicle. While proposed § 1.163-16(d)(2)(i) provided that an SPVL also includes indebtedness incurred for items or amounts customarily financed in an APV purchase transaction and that are directly related to the purchase of the APV, negative equity on an existing vehicle loan is not related to the purchase of the APV—the negative equity instead relates to a prior vehicle purchase transaction that is distinct from and unrelated to the APV purchase. Moreover, allowing amounts representing negative equity to be included in an SPVL would allow taxpayers to deduct interest attributable to indebtedness incurred prior to 2025 or for the purchase of a vehicle that is not an APV. Accordingly, the final regulations exclude amounts of indebtedness attributable to negative equity from being an SPVL.

c. *Method of Allocating Interest*

Proposed § 1.163-16(d)(2)(iii)(A) provided that in the case of indebtedness that is partially an SPVL, payments of interest and principal are allocated on a pro rata basis between the portion of indebtedness that is an SPVL and the portion of indebtedness that is not an SPVL.

Two commenters requested guidance on acceptable allocation methods or, alternatively, requested confirmation as to whether reasonable allocation methods will be permitted. However, neither commenter suggested any examples of an allocation method different from the pro rata method contained in the proposed regulations. Another commenter proposed calculating the amount of deductible interest on a proportional basis. For example, if a consumer financed a vehicle with a balance of $50,000 and $5,000 of that balance was determined to not be an SPVL, deductible interest would be 90 percent (45,000/50,000) of the total interest paid with 10 percent (5,000/50,000) being non-deductible.

The final regulations require the use of the pro rata allocation method and do not provide for any other allocation method. The final regulations also add an example illustrating the pro rata allocation method. See § 1.163-16(d)(6)(v).

2. *Refinancing*

Section 163(h)(4)(E)(ii) generally provides that a new loan resulting from refinancing an SPVL is an SPVL if the new loan is secured by a first lien on the APV with respect to which the refinanced SPVL was incurred, but only to the extent the amount of the new loan does not exceed the amount of the refinanced SPVL. This proposed rule was described in proposed § 1.163-16(d)(4), which clarified that the amount of the new loan that is an SPVL is limited to the outstanding balance of the refinanced SPVL as of the date of the refinancing. Consistent with section 163(h)(4)(B)(i) and (h)(4)(D)(i), proposed § 1.163-16(d)(5)(i) provided that the SPVL must have been originally incurred by the taxpayer, and proposed § 1.163-16(d)(4) provided that, if there is a change in obligor as part of the refinancing, the new loan is not an SPVL with regard to any obligor other than the original obligor unless the refinancing is in connection with a change in obligor by reason of the obligor's death within the meaning of proposed § 1.163-16(d)(5)(ii).

A number of commenters requested that the Treasury Department and the IRS clarify in the final regulations whether additional APV-related products or customary amounts incurred in a refinancing (for example, refinancing charges and vehicle-related consumer protection products, including warranties and insurance products) constitute indebtedness that is an SPVL. The commenters described a typical situation in which the customer refinances the loan to purchase an APV shortly after the customer purchased the APV (for example, to get a lower interest rate than the rate charged by the dealer). As part of the refinancing, the customer finances the purchase of what would otherwise be "customarily financed" items or amounts in an APV purchase transaction, such as GAP insurance, that the customer did not purchase in connection with the original APV purchase transaction.

The Treasury Department and the IRS do not adopt these requests. Under section 163(h)(4)(E)(ii), if an SPVL is refinanced, the new loan cannot qualify as an SPVL to the extent the amount of the new loan exceeds the amount of the refinanced SPVL. The inclusion of amounts in excess of the amount of the refinanced loan, even if such amounts are attributable to products or amounts related to or customarily incurred with the purchase of an APV, would conflict with the plain language of the statute. Accordingly, the final regulations do not adopt these comments.

Several commenters requested that the Treasury Department and the IRS clarify in the final regulations whether the inclusion of additional obligors in a refinancing of an SPVL would result in the new loan failing to qualify as an SPVL. Consistent with section 163(h)(4)(B)(i) and (h)(4)(D)(i), and as provided in proposed § 1.163-16(d)(5)(i), indebtedness is an SPVL only if it was originally incurred by the taxpayer. Accordingly, the Treasury Department and the IRS clarify that in the event a new borrower is added to indebtedness as part of a refinancing of an SPVL, the indebtedness continues to be an SPVL with respect to the original obligor(s), but is not an SPVL with respect to the new obligor(s).

One commenter requested clarification as to whether interest attributable to prior vehicle loan balances on an SPVL that are rolled into a new loan as part of a refinancing may be included in the new SPVL to the extent those balances are part of the amount financed. The final regulations provide that the amount of a new loan, to the extent attributable to accrued but unpaid interest on the refinanced SPVL, may qualify as an SPVL provided all the other requirements to be an SPVL are satisfied.

E. *Applicable Passenger Vehicle (APV)*

Section 163(h)(4)(D) defines APV as meaning any vehicle: (i) the original use of which commences with the taxpayer; (ii) that is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails); (iii) that has at least 2 wheels; (iv) that is a car, minivan, van, sport utility vehicle, pickup truck, or motorcycle; (v) that is treated as a motor vehicle for purposes of title II of the Clean Air Act; and (vi) that has a GVWR of less than 14,000 pounds. Section 163(h)(4)(D) also provides that the term APV does not include any vehicle the final assembly of which did not occur within the United States.

1. *Original Use*

Section 163(h)(4)(D) provides, in relevant part, that for a vehicle to be an APV, the original use of the vehicle must commence with the taxpayer. Proposed § 1.163-16(e)(2)(i) provided that original use of a vehicle commences with the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled. In the case of a dealer, proposed § 1.163-16(e)(2)(i) provided that original use of a vehicle does not commence with the dealer unless the dealer registers or titles the vehicle. In the case of a purchaser that is not a dealer and that incurs indebtedness to purchase a vehicle, proposed § 1.163-16(e)(2)(i) provided that original use of the vehicle does not commence with that purchaser unless the vehicle is treated as a new vehicle under the loan documentation.

One commenter requested clarity regarding the definition of "new vehicle" in proposed § 1.163-16(e)(2)(i). The Treasury Department and the IRS clarify that the requirement that a vehicle be treated as a new vehicle under the loan documentation refers to the lender's classification of the vehicle for purposes of its financing programs.

Multiple commenters recommended that the definition of APV be extended to include used or "nearly-new" vehicles. Several of these commenters noted that the definition should be changed because lower-income taxpayers cannot afford to purchase new vehicles. Section 163(h)(4)(D) provides, in relevant part, that for a vehicle to be an APV, the original use of the vehicle must commence with the taxpayer. If the original use of a vehicle commences with a person other than the taxpayer, the vehicle is not an APV in the hands of the taxpayer. Allowing a taxpayer that does not satisfy the original use requirement to treat the vehicle as an APV would be in direct conflict with the plain language of the statute and congressional intent. Accordingly, the Treasury Department and the IRS decline to adopt this recommendation.

Multiple commenters noted that State vehicle titling and registration requirements for demonstrator vehicles vary by State, leading to differing consumer outcomes in different jurisdictions. Specifically, the commenters noted that in States that require a dealer to title or register demonstrator vehicles, the original use of that vehicle would always commence with the dealer and therefore would never commence with a purchaser that is not a dealer. One commenter noted that this rule is arbitrary, and recommended the final regulations provide that original use of a vehicle be deemed to commence with the first purchaser that is not a dealer, notwithstanding any prior temporary use or titling by the dealer for demonstrator or service vehicle purposes.

The Treasury Department and the IRS understand and appreciate that taxpayers are concerned that dealers' prior use of vehicles could prevent original use from commencing with a subsequent purchaser that is not a dealer, including concerns that this result may vary among States. Accordingly, § 1.163-16(e)(2)(ii) provides that original use of a vehicle held by a dealer does not commence with the dealer if the vehicle is held primarily for sale to customers in the ordinary course of its trade or business, and as a result the dealer is not considered to be the first person that takes delivery of the vehicle after it is sold, registered, or titled as described in § 1.163-16(e)(2)(i). However, original use of a vehicle may commence with a dealer if the vehicle is held by the dealer for any purpose other than primarily for sale to customers in the ordinary course of its trade or business. For example, a dealer may own a service vehicle that is not held primarily for sale to customers and instead is used to support the dealer's business operations, such as use as a customer loaner. Original use of this service vehicle will generally begin with the dealer. In contrast, a dealer may own a demonstrator vehicle that is held primarily for sale to customers and is used for customer test drives. Original use of this demonstrator vehicle will generally not begin with the dealer and instead may begin with a customer that purchases the vehicle. This rule is consistent with similar concepts in the Code, such as the original use requirement for certain property to be eligible for the additional first year depreciation deduction under section 168(k)(2)(A)(ii) of the Code. Section 1.168(k)-2(b)(3)(i) and (b)(3)(ii)(A) provide in relevant part that depreciable property meets the requirement if the original use of the property commences with the taxpayer. Section 1.168(k)-2(b)(3)(ii)(A) explains that original use means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. Example 2 in § 1.168(k)-2(b)(3)(vii)(B) applies the original use requirement to a dealer's use of a vehicle as a demonstrator for prospective customers while the vehicle is held primarily for sale to customers in the ordinary course of the dealer's business, concluding that the dealer's "use" of a vehicle as a demonstrator does not constitute "original use" of the vehicle for the purposes of meeting the original use requirement. Similarly, § 1.163-16(e)(2)(v)(A) (*Example 1: Demonstrator vehicles*) of the final regulations addresses how § 1.163-16(e)(1)(i) and (e)(2) apply when a vehicle is used by a dealer as a demonstrator vehicle while primarily being held for sale to customers in the ordinary course of its trade or business.

Additionally, consistent with proposed § 1.163-16(e)(2)(i), § 1.163-16(e)(2)(i) provides that in the case of any purchaser that incurs indebtedness for the vehicle purchase, original use of the vehicle does not commence with that purchaser unless the loan documentation treats the vehicle as a new vehicle. This rule aligns with the requirement in section 163(h)(4)(D)(i) that for a vehicle to be an APV, the original use of the vehicle for which indebtedness is incurred must commence with the taxpayer.

One commenter asked how the proposed original use rule in proposed § 1.163-16(e)(2)(i) would apply in the case of two individuals who purchase a vehicle when both individuals are listed on the vehicle's title and are obligors on the loan incurred to finance the purchase. Alternatively, the commenter asked how the proposed rule applied if the two individuals purchase the vehicle and are obligors on the loan incurred to finance the purchase, but only one of the individuals is listed on the title.

The Treasury Department and the IRS confirm that if a vehicle is purchased by more than one person, then original use of that vehicle may commence with each of these purchasers. Accordingly, § 1.163-16(e)(2)(iii) provides that if more than one person purchases a vehicle and one of these purchasers is the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled, then each of these purchasers is considered to be the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled as described in § 1.163-16(e)(2)(i).

Multiple commenters requested clarity regarding the application of the proposed original use rule in the case of a leased vehicle that is eventually purchased by the lessee.

The Treasury Department and the IRS understand that leased vehicles are often purchased by the lessee either during or at the end of the vehicle lease term. It is common for original use of a leased vehicle to commence with the lessor, in which case original use would not commence with a lessee that purchases the vehicle. Additionally, if a lessee purchases a vehicle during or at the end of a vehicle lease term and finances that purchase by incurring a loan, the loan documentation generally does not treat the vehicle as a new vehicle. As a result, the original use of the vehicle would not commence with the lessee under § 1.163-16(e)(1)(i). Section 1.163-16(e)(2)(v)(C) (*Example 3: Vehicle purchase following a lease*) addresses how § 1.163-16(e)(1)(i) and (e)(2) apply when a lessee purchases a vehicle at the end of the lease term.

Multiple commenters requested clarification regarding whether original use of a vehicle manufactured in a prior year but not purchased until a subsequent year (for example, a 2025 model year vehicle that was sold to a purchaser that is not a dealer in 2026 after the manufacturer's release of a 2026 model year vehicle) may commence with the purchaser. The Treasury Department and the IRS confirm that original use of a vehicle commences with a taxpayer as described in § 1.163-16(e)(2), regardless of whether the vehicle was manufactured in a prior year but not sold until a subsequent year.

2. *Vehicles with Temporary Living Quarters*

One commenter requested clarity regarding whether a self-propelled vehicle designed to provide temporary living quarters for recreational, camping, or seasonal use could be an APV. In order to be an APV, a vehicle must meet the requirements to be an APV at the time of purchase. The Treasury Department and the IRS confirm that a vehicle that meets the section 163(h)(4)(D) requirements at the time of purchase will be considered an APV, regardless of whether the vehicle was designed to provide temporary living quarters.

3. *Final Assembly*

Section 163(h)(4)(D) provides that the definition of APV does not include any vehicle the final assembly of which did not occur within the United States. Section 163(h)(4)(E)(i) provides that, for the purposes of section 163(h)(4)(D), the term "final assembly" means the process by which a manufacturer produces a vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle. Proposed § 1.163-16(e)(3) provided that, to establish that final assembly occurred within the United States, the taxpayer may rely on (1) the vehicle's plant of manufacture as reported in the VIN under 49 CFR 565; or (2) the final assembly point reported on the label affixed to the vehicle as described in 49 CFR 583.5(a)(3). Further, the preamble to the proposed regulations provided that taxpayers could determine whether the vehicle's plant of manufacture is located in the United States by following the instructions on the National Highway Traffic Safety Administration (NHTSA) VIN Decoder website: https://www.nhtsa.gov/vin-decoder.

One commenter recommended that APVs should include all new vehicles regardless of where the vehicles are manufactured. Another commenter recommended an exemption to the final assembly requirement for any vehicle manufactured by certain large U.S. vehicle manufacturers. The Treasury Department and the IRS do not adopt these recommendations because section 163(h)(4)(D) explicitly requires that a vehicle must have undergone final assembly in the United States to be an APV.

One commenter noted that certain vehicle models with identical specifications may have undergone final assembly either in the United States or in other countries. Accordingly, the commenter recommended that the final assembly determination be made at the vehicle make-and-model level rather than at the VIN level to ensure taxpayers purchasing the same model vehicle are not treated differently under the Code. Alternatively, the commenter recommended that transitional or safe harbor provisions be considered for vehicle models that may have undergone final assembly either in the United States or in other countries.

The Treasury Department and the IRS understand that not all vehicles of the same make and model undergo final assembly in the same location and where a vehicle's final assembly occurred cannot be determined reliably from its make and model. For example, the final assembly of some vehicles of a make and model marketed by a U.S.-headquartered manufacturer may in certain cases have occurred outside the United States, while some vehicles of a make and model marketed by a non-U.S.-headquartered manufacturer may have occurred in the United States. Nonetheless, section 163(h)(4)(D) explicitly provides that a vehicle must have undergone final assembly in the United States to be an APV. Accordingly, the Treasury Department and the IRS do not adopt this commenter's recommendations.

One commenter noted that it was unclear what should be done if the NHTSA VIN Decoder website is unavailable. The Treasury Department and the IRS note that reliance on the vehicle's plant of manufacture as reported in the VIN (which can be checked on the NHTSA VIN Decoder website) to establish the location of final assembly is one non-exclusive option provided by the IRS for taxpayers' convenience. A taxpayer may also determine where a vehicle's final assembly occurred by relying on the vehicle's final assembly point reported on the label affixed to the vehicle as described in 49 CFR 583.5(a)(3), which is sometimes referred to as the "window sticker."

F. *Personal Use*

Section 163(h)(4)(B)(i) provides that QPVLI is interest paid or accrued on indebtedness incurred by the taxpayer for the purchase of an APV for personal use. Proposed § 1.163-16(f)(1) provided that a taxpayer that incurs indebtedness to purchase an APV is considered to purchase that APV for personal use if, at the time the indebtedness is incurred, that taxpayer expects that the APV will be used for personal use by the taxpayer, the taxpayer's spouse, or an individual that is related to the taxpayer within the meaning of section 152(c)(2) or (d)(2) of the Code, or any combination of these individuals, for more than 50 percent of the time.

One commenter asked if the personal use determination is made annually or only at the time the vehicle is purchased. Additionally, multiple commenters asked whether the personal use determination is affected by a change in the way a vehicle is used after the indebtedness is incurred.

The Treasury Department and the IRS reaffirm that the personal use requirement in section 163(h)(4) is a requirement that must be satisfied at the time the indebtedness is incurred, and not an ongoing requirement. Accordingly, differences between expected use at the time the indebtedness is incurred and later actual use of the vehicle do not affect the personal use determination.

One commenter noted that the proposed regulations would complicate recordkeeping and the audit process by requiring taxpayers that use a vehicle for personal and business purposes to allocate interest between QPVLI and business interest.

Proposed § 1.163-16(g)(2) provided that taxpayers may deduct independently deductible interest (generally, interest that is QPVLI and that also is deductible as a different type of interest under section 163(a) or a different section of the Code) as either QPVLI or as a different type of interest as described in proposed § 1.163-16(g)(1). Accordingly, taxpayers that use a vehicle for personal and business purposes are not required to allocate interest between QPVLI and business interest, but may choose to do so.

G. *QPVLI Limitations*

1. *Dollar Limitation*

Section 163(h)(4)(C)(i) provides that the deduction allowed for QPVLI by a taxpayer for any taxable year cannot exceed $10,000. Proposed § 1.163-16(h)(1) provided that the amount taken into account as QPVLI by a taxpayer for any taxable year may not exceed $10,000 per Federal tax return regardless of filing status.

One commenter requested that the Treasury Department and the IRS clarify how the rules work if a taxpayer has multiple SPVLs. The commenter recommended that taxpayers be able to aggregate interest from all SPVLs to determine QPVLI and apply the $10,000 per return limit to this total amount.

The Treasury Department and the IRS clarify that under section 163(h)(4) a taxpayer with multiple SPVLs may aggregate interest from these loans to determine the total amount of QPVLI prior to applying the $10,000 per return limit.

2. *Modified Adjusted Gross Income Phaseout*

Section 163(h)(4)(C)(ii) provides and proposed § 1.163-16(h)(2) provided that the amount otherwise allowable as a deduction under section 163(a) as QPVLI (after the application of the section 163(h)(4)(C)(i) dollar limitation) is reduced (but not below zero) by $200 for each $1,000 (or portion thereof) by which the modified adjusted gross income (MAGI) of the taxpayer for the taxable year exceeds $100,000. In the case of married taxpayers filing a joint Federal income tax return, section 163(h)(4)(C)(ii) provides and proposed § 1.163-16(h)(2) provided that this reduction begins after the taxpayer's MAGI exceeds $200,000.

Multiple commenters requested clarification regarding the application of the MAGI phaseout to taxpayers that file a Federal income tax return with a filing status of head of household. The MAGI phaseout thresholds for all taxpayers are explicitly set by section 163(h)(4)(C)(ii), which provides two specific dollar amount thresholds: a $200,000 phaseout threshold applicable to joint filers and a $100,000 phaseout threshold applicable to all other taxpayers, including taxpayers that have a filing status of head of household. Accordingly, comments requesting a change in the phaseout threshold amount for taxpayers that have a filing status of head of household are not adopted.

Multiple commenters recommended that final regulations increase the MAGI phaseout thresholds. One of these commenters requested a separate increased threshold for taxpayers that file a Federal income tax return with a filing status of head of household. The Treasury Department and the IRS decline to adopt these recommendations because section 163(h)(4)(C)(ii) explicitly provides the MAGI phaseout thresholds for all taxpayers.

Multiple commenters recommended that the MAGI phaseout reduce the $10,000 annual limitation on QPVLI under section 163(h)(4)(C)(i), rather than reduce the amount otherwise deductible as QPVLI under section 163(a). Section 163(h)(4)(C)(ii) explicitly requires that the amount otherwise allowable as a deduction under section 163(a) be reduced as a taxpayer's MAGI exceeds the applicable dollar amount thresholds. Accordingly, the Treasury Department and the IRS do not adopt these recommendations.

H. *Taxpayers That May Deduct QPVLI*

Section 163(h)(4)(B)(i) provides that QPVLI is interest paid or accrued on indebtedness incurred by the taxpayer for the purchase of an APV for personal use. Because business entities cannot satisfy the personal use requirement, proposed § 1.163-16(a)(2)(i) provided that only individuals, decedents' estates, and non-grantor trusts may deduct QPVLI.

One commenter requested that the Treasury Department and the IRS clarify in the final regulations whether nonresident alien individuals may deduct QPVLI. The commenter noted that section 873(b) of the Code lists the nonbusiness deductions allowed for nonresident alien individuals and does not include QPVLI in this list.

The Treasury Department and the IRS agree with the commenter that clarification on whether nonresident alien individuals may deduct QPVLI is needed. With limited exceptions, a nonresident alien individual is not allowed deductions that are not connected with income that is effectively connected with the conduct of a U.S. trade or business. See section 873. Thus, a nonresident alien individual will generally not be allowed to deduct QPVLI, which relates to indebtedness incurred to purchase an APV for personal use. However, in limited circumstances, interest connected to income that is effectively connected with the conduct of a U.S. trade or business will qualify as QPVLI. For example, a nonresident alien individual that purchases an APV primarily for personal use may also use the APV as part of his or her trade or business, and thus may pay interest that qualifies as QPVLI. See part II.F (*Personal Use*) of this Summary of Comments and Explanation of Revisions. In that case, the nonresident alien individual would be allowed under § 1.163-16(g)(2) to deduct the interest connected to that business as either QPVLI or as business interest expense. This same analysis would apply to a decedent's estate that is a foreign estate or a non-grantor trust that is a foreign trust, each of which computes its taxable income in the same manner as a nonresident alien individual. See section 641(b) of the Code. The Treasury Department and the IRS intend to modify the instructions for the relevant forms to clarify that a nonresident alien individual, foreign estate, or foreign non-grantor trust is not allowed to deduct QPVLI, except in the limited circumstances described in this paragraph.

One commenter requested that U.S. citizens residing in the Commonwealth of Puerto Rico that are required to file a Federal tax return be allowed to deduct QPVLI. U.S. citizens residing in the Commonwealth of Puerto Rico that are required to file a Federal tax return are generally entitled to claim deductions to the extent those deductions are properly allocated and apportioned pursuant to the rules under sections 861 and 933 of the Code and the regulations thereunder. Accordingly, these taxpayers may be eligible to deduct QPVLI, subject to the allocation and apportionment rules in sections 861 and 933.

One commenter recommended that individuals with any filing status (including single, married filing jointly, and head of household) should be able to deduct QPVLI. The Treasury Department and the IRS confirm that filing status does not impact QPVLI deduction eligibility.

III. *Comments on Proposed § 1.6050AA-1*

A. *In General*

In order to make the regulations more readable, the final regulations include two revisions to the proposed rules that move language from the definitions in § 1.6050AA-1(b) to other paragraphs in § 1.6050AA-1. First, the language in proposed § 1.6050AA-1(b)(3)(ii) (*Interest received on behalf of another person*) has been moved to new § 1.6050AA-1(c), and the subsequent paragraphs in § 1.6050AA-1(b) have been finalized accordingly. Second, the language in proposed § 1.6050AA-1(b)(2)(ii) (*De minimis rule*) and (e) (*Amount of interest received on SPVL for calendar year*) have been grouped together in new § 1.6050AA-1(f)(1) and (2), respectively. As a result, the language in proposed § 1.6050AA-1(b)(2)(i) has been moved to § 1.6050AA-1(b)(2) and the heading in proposed § 1.6050AA-1(b)(2)(i) has been deleted. As discussed more fully in this part III of the Summary of Comments and Explanation of Revisions (*Comments on Proposed § 1.6050AA-1*), the substantive contents of these provisions have not been revised in the final regulations.

B. *Definitions*

1. *Applicable Passenger Vehicle (APV)*

Section 6050AA(d)(1) provides that terms used in section 6050AA have the same meaning as when used in section 163(h)(4). The term APV is used in section 6050AA(b)(2)(E) and (d)(2). Section 163(h)(4)(D) defines an APV as a vehicle that satisfies the requirements of section 163(h)(4)(D)(i) through (vi), but excludes from the definition any vehicle the final assembly of which did not occur within the United States.

Proposed § 1.6050AA-1(b)(1) provided that the term "applicable passenger vehicle" or "APV" has the same meaning as that provided in section 163(h)(4)(D) and proposed § 1.163-16(b)(1). Proposed § 1.163-16(b)(1) provided that a vehicle is an "applicable passenger vehicle" or "APV" if it satisfies the requirements set forth in proposed § 1.163-16(e)(1). Proposed § 1.163-16(e)(1) further provided that a vehicle is an APV only if it satisfies the requirements set forth in section 163(h)(4)(D). Proposed § 1.163-16(e)(2) and (3), respectively, provided rules for determining whether original use commences with the taxpayer and whether final assembly occurred in the United States.

Many commenters expressed general disapproval of the requirement for interest recipients to determine if a vehicle is an APV, a vehicle that satisfies the requirements that are set forth in section 163(h)(4)(D) and proposed § 1.163-16(b)(1). These commenters generally claimed that it would be burdensome for interest recipients to determine if a vehicle is an APV because interest recipients do not currently have the information necessary to make this determination. Specifically, several commenters claimed that interest recipients do not currently maintain records that include whether the vehicle's original use commences with the borrower, the vehicle's GVWR, where the vehicle's final assembly occurred, or whether the vehicle satisfies other APV requirements. These commenters generally recommended that the final regulations allow interest recipients to report interest on all vehicle loans and recommended that individual taxpayers seeking to claim the deduction alone should determine whether their vehicle qualifies as an APV.

The Treasury Department and the IRS acknowledge the concerns raised by these commenters and are aware that interest recipients may need to collect additional information to determine whether a vehicle is an APV. However, as a result of the statutory interaction between sections 6050AA(d)(1) and 163(h)(4)(D), determining whether a vehicle is an APV is necessary to determine whether reporting is required under section 6050AA. See part II.E of this Summary of Comments and Explanation of Revisions (*Applicable Passenger Vehicle (APV)*) for a discussion of the regulations under section 163(h)(4)(D). In addition, taxpayers need the information reported under section 6050AA to accurately complete their Federal income tax returns. Information reported on the Form 1098-VLI, *Vehicle Loan Interest Statement*, such as the vehicle's VIN, whether the original use of the vehicle began with the purchaser (payor of record), and whether final assembly occurred in the United States, will enable taxpayers to accurately claim the QPVLI deduction.

Several commenters discussed their concerns about using a vehicle's VIN to verify where a vehicle's final assembly occurred. One commenter indicated that the commenter understands the vehicle's VIN indicates the plant of manufacture; however, the commenter noted that while taxpayers and dealers have access to the vehicle's window label, the interest recipient may not. One commenter requested simplified VIN and final assembly verification. Another commenter requested that the final regulations allow interest recipients to report the VIN reflected in their records without requiring the interest recipients to verify where a vehicle's final assembly occurred.

The statutory text of section 6050AA(b)(2)(E) requires interest recipients to report VINs. See part III.F of this Summary of Comments and Explanation of Revisions (*Requirement to File an Information Return*) for a discussion of the requirement to report the APV's VIN. Although these interest recipients may not currently have easy access to a VIN, they must obtain VINs to comply with their statutory information reporting obligations. Further, the Treasury Department and the IRS understand the VIN and the NHTSA VIN lookup tool can be used to determine whether a vehicle has a GVWR of less than 14,000 pounds and whether the final assembly of the vehicle occurred within the United States. Accordingly, no changes are made in the final regulations to the text of proposed § 1.6050AA-1(b)(1) in response to these comments.

Other commenters requested safe harbor provisions related to the determination of whether a vehicle is an APV. One commenter requested that the Treasury Department and the IRS consider including a safe harbor in the final regulations to allow interest recipients to rely on dealer or manufacturer data to make the APV determination. Another commenter requested that the Treasury Department and the IRS provide a safe harbor in the final regulations allowing lenders to rely on loan documentation and dealer certifications regarding new vehicle status and original use.

The Treasury Department and the IRS decline to adopt a safe harbor for interest recipients with respect to determining whether a vehicle satisfies the requirements of section 163(h)(4)(D). Section 6001 of the Code provides that every person liable for tax or the collection thereof must keep such records, render such statements, make such returns, and comply with such rules and regulations as may be prescribed. Under § 1.6001-1(a), any person required to file a return of information with respect to income must keep such permanent books of accounts or records sufficient to establish the matters required to be shown in any return of such information. This includes all of the information required by section 6050AA, which is information that lenders can obtain. The general recordkeeping requirements require interest recipients to establish the items required to be shown on the section 6050AA information return. See part III.B.2 of this Summary of Comments and Explanation of Revisions (*Specified Passenger Vehicle Loan (SPVL)*) for a discussion of interest recipients' obligations when the vehicle is refinanced.

2. *Specified Passenger Vehicle Loan (SPVL)*

Section 6050AA(d)(2) provides that the term "specified passenger vehicle loan" means the indebtedness described in section 163(h)(4)(B) with respect to any APV. Proposed § 1.6050AA-1(b)(7) provided that the term "specified passenger vehicle loan" or "SPVL" has the meaning provided in proposed § 1.163-16(b)(15). Proposed § 1.163-16(b)(15) provided that "specified passenger vehicle loan" or "SPVL" means indebtedness that satisfies the requirements set forth in proposed § 1.163-16(d)(1). Proposed § 1.163-16(d)(1) provided that SPVL means indebtedness that is incurred by the taxpayer after December 31, 2024, for the purchase of, and that is secured by a first lien on, an APV for personal use.

Many commenters requested that the final regulations not require interest recipients to report interest received on an SPVL. In general, these commenters requested that the final regulations require interest recipients to report interest received on any vehicle loan rather than only on an SPVL. Most of these commenters claimed interest recipients do not currently possess sufficient information to determine whether a loan is an SPVL.

Many commenters indicated that interest recipients do not currently collect or maintain information relating to whether a loan meets the requirements of section 163(h)(4)(B). Some commenters claimed that specific interest recipients, including credit unions, do not currently track all the information necessary to determine the interest allocable to different components of a vehicle loan. Other commenters claimed that interest recipients do not currently track interest allocable to negative equity or the amount of nonqualifying indebtedness.

Some commenters requested that the final regulations include safe harbors that would allow the interest recipients to report interest received on any vehicle loan rather than the amount of interest received only on an SPVL. One commenter requested that the final regulations include a safe harbor under which interest recipients are not required to allocate interest between qualifying and non-qualifying portions of the vehicle loan. Another commenter requested that the final regulations include a safe harbor allowing interest recipients to provide interest statements to any borrower who paid $600 or more in interest on a vehicle-secured loan, accompanied by a disclaimer.

Some commenters indicated their view that certain requirements of section 163(h)(4)(B) are known only to the taxpayer. Some commenters claimed that only taxpayers are able to know whether the vehicle loan was incurred for the purchase of an APV for personal use. Others claimed that vehicle finance companies process changes of party to vehicle finance contracts from time to time, but do not currently have data regarding whether the death of the original payor of record is the reason for such transfer. These commenters generally requested that the final regulations require that the taxpayer, rather than the interest recipient, be responsible for determining whether a vehicle loan is an SPVL.

The statutory language does not support permitting interest recipients to report interest received on all vehicle loans. Section 6050AA(a) provides that the information return relates to interest received on an SPVL. Section 6050AA(b)(2) provides that the information return filed by the interest recipient must include the amount of such interest received for the calendar year. The interest referred to in section 6050AA(b)(2) is the interest received on an SPVL. The Treasury Department and the IRS understand that the definition of SPVL in § 1.6050AA-1(b)(7) may require interest recipients to collect information they do not currently collect. However, the statute requires reporting of interest received on an SPVL, not vehicle loan interest in general.

Several commenters discussed whether interest recipients can determine whether a taxpayer expects to use the vehicle for personal use. One commenter requested that the final regulations provide an objective, standardized mechanism for establishing personal use at origination that credit unions can document through ordinary loan records. Another commenter requested that the final regulations provide that interest recipients need only rely on the information contained in the retail installment sales contract. This commenter also requested that the final regulations include a safe harbor regarding the personal use of the vehicle.

The Treasury Department and the IRS understand that interest recipients may not currently have documentation necessary to determine whether the personal use requirement is met. While retail installment sales contracts may include some indication of whether a vehicle is purchased for personal or business use, this is not true of all such contracts. Further, even when a contract includes some indication of use, this information may not be available to assignees of the loan. If the information in the contract is sufficient for the interest recipient to determine that the personal use requirement is met, then, in the absence of conflicting information, the interest recipient may rely on that information. With respect to other contracts, the interest recipient may choose to make arrangements to obtain information regarding personal use from the obligor, from the lender of record, or by other means. In addition, interest recipients may rely on the same evidence of personal use as the obligor.

Several commenters discussed what they consider to be unique issues when an SPVL is refinanced. In general, these commenters claimed that interest recipients after refinancing do not currently have access to the information needed to verify that the refinanced debt was an SPVL in the first instance. One commenter noted that there are currently no reliable mechanisms to confirm whether the borrower was the original owner during a refinance transaction or whether a refinanced vehicle was purchased during a qualifying year.

Some commenters requested that the final regulations adopt different, specific reporting requirements when a vehicle-secured loan is refinanced. These commenters claimed that, in a typical vehicle refinance transaction, lenders do not receive a copy of the prior retail installment sales contract, and that refinance lenders generally receive limited information. Some commenters recommended that the final regulations clarify that interest recipients may report interest paid on vehicle-secured refinance loans without making determinations regarding original purchase eligibility and that vehicle eligibility determinations remain solely with the taxpayer. One commenter requested that the final regulations allow lenders to treat the entire refinanced amount as an SPVL, up to the payoff amount reflected on the prior lender's payoff statement, without ongoing pro rata interest allocation that lender systems are not currently designed to perform. Another commenter requested that the final regulations clarify that, for purposes of section 6050AA reporting, interest recipients may rely on a signed borrower certification of original ownership.

The Treasury Department and the IRS acknowledge the concerns raised by these commenters and are aware that interest recipients may need to collect more information with respect to refinanced vehicle loans in order to determine whether the vehicle loan is an SPVL. However, as a result of the interaction between sections 6050AA(d) and 163(h)(4)(B), determining whether the vehicle loan is an SPVL is necessary to determine whether reporting is required under section 6050AA. Section 163(h)(4)(E)(ii) generally provides that a new loan resulting from refinancing an SPVL is an SPVL if the new loan is secured by a first lien on the APV with respect to which the refinanced SPVL was incurred, but only to the extent the amount of the new loan does not exceed the amount of the refinanced SPVL. The statute does not include separate rules for reporting interest received on an SPVL that meets the requirements of section 163(h)(4)(E)(ii). Accordingly, interest recipients must perform adequate diligence to meet their reporting requirements for refinanced SPVLs.

Some commenters noted that it would be useful for the amount of interest reported under section 6050AA to be the same as the amount of interest an eligible borrower would be allowed to deduct. The Treasury Department and the IRS agree with these commenters. The Treasury Department and the IRS acknowledge that it is not possible for interest recipients to know whether the amount of the SPVL is limited by the dollar or MAGI limitations in section 163(h)(4)(C). Therefore, to minimize the risk of recipients claiming an interest deduction that exceeds the limitation imposed by section 163(h)(4)(C), § 1.6050AA-1(h)(2)(iv) requires that the written statement from the interest recipient include a legend stating that the payor of record may be unable to deduct the full amount of interest reported on the statement. See part III.G of this Summary of Comments and Explanation of Revisions (*Requirement to Furnish a Written Statement*) for a further discussion of the legend.

3. *Calendar Year*

Proposed § 1.6050AA-1(b)(2) provided that the calendar year for which interest is received is the later of the calendar year for which interest is received or the calendar year in which the interest properly accrues. Proposed § 1.6050AA-1(b)(2)(ii) permitted an interest recipient to report, as interest received during the calendar year, prepaid interest properly accruing by the following January 15.

One commenter requested guidance for handling payment reversals that cross calendar years and other corrections that occur after year-end processing cutoffs.

The Treasury Department and the IRS decline to include a rule in the final regulations on how to correct information returns under section 6050AA. IRS Publication 1099, *General Instructions for Certain Information Returns*, includes information on how to file corrected information returns and interest recipients should use those instructions to determine how to file any corrected returns.

In order to make the regulations more readable, however, the language in proposed § 1.6050AA-1(b)(2)(ii) (*De minimis rule*) has been moved to new § 1.6050AA-1(f)(1) and the heading has been updated.

4. *Interest Recipient*

Proposed § 1.6050AA-1(b)(3) provided that the term "interest recipient" means a person that is engaged in a trade or business, whether or not the trade or business of lending money, and who, in the course of that trade or business, receives interest on an SPVL. When a person collects interest on an SPVL on behalf of another, proposed § 1.6050AA-1(b)(3)(ii) provided that the person that first receives the interest generally would be required to report under proposed § 1.6050AA-1(a), and no reporting would be required upon the transfer of the interest from the interest recipient to the person on whose behalf the interest recipient received the interest. However, if the initial recipient does not possess the reporting information for the borrower and the person on whose behalf the interest recipient received the interest is engaged in a trade or business and would receive the interest in the course of its trade or business if it received the interest directly, proposed § 1.6050AA-1(b)(3)(ii)(A) would require the person on whose behalf the interest recipient received the interest, rather than the initial recipient, to report.

One commenter requested clarification regarding which party should be considered the interest recipient in a securitization structure for retail installment sales contracts. This commenter also requested confirmation that parties may contractually delegate reporting obligations to another party and, when a delegation occurs, clarification of which party bears the obligation for a given calendar year.

No modifications are needed in the final regulations to the text of proposed § 1.6050AA-1(b)(3) in response to this comment. Home mortgages have historically been securitized, and the final regulations are similar to the interest recipient rules for mortgage interest in § 1.6050H-1(c). The Treasury Department and the IRS decline to provide an example regarding the specific fact pattern included in the comment. However, the new examples in § 1.6050AA-1(c)(5) generally illustrate the effect of the definition when a car loan is securitized.

The Treasury Department and the IRS understand that when a vehicle loan is securitized the interest recipient may not currently have ready access to the information necessary to determine if a vehicle satisfies the requirements to be an APV, or information regarding whether a loan is an SPVL. However, as discussed in parts III.B.1 and III.B.5 of this Summary of Comments and Explanation of Revisions (*Applicable Passenger Vehicle (APV)* and *Specified Passenger Vehicle Loan (SPVL)*, respectively), such determinations are required by statute.

One commenter requested that the regulations address how reporting obligations should be satisfied if the interest recipient enters bankruptcy or is otherwise unable to report for a calendar year. The Treasury Department and the IRS decline to address the consequences of bankruptcy on an interest recipient's reporting obligation because it is outside the scope of these regulations.

To make the regulations more readable, the language in proposed § 1.6050AA-1(b)(3)(ii) (*Interest received on behalf of another person*) has been moved to new § 1.6050AA-1(c). As a result, the language in proposed § 1.6050AA-1(b)(3)(i) has been moved to § 1.6050AA-1(b)(3) and the heading in proposed § 1.6050AA-1(b)(3)(i) has been deleted. In addition, the new examples in § 1.6050AA-1(c)(5) illustrate the reporting obligation when a person collects interest on an SPVL on behalf of another when a car loan is securitized.

5. *Payor of Record*

Proposed § 1.6050AA-1(b)(5) defined a "payor of record" on an SPVL as any person carried on the books and records of the interest recipient as the principal borrower on the SPVL. As a result of the interaction between proposed § 1.6050AA-1(b)(5) and (a)(2), only the payor of record would be furnished a written statement on the SPVL under proposed § 1.6050AA-1(a)(2)(ii). Proposed § 1.6050AA-1(b)(5) also provided that the term "person" for the purposes of proposed § 1.6050AA-1(b)(5) means any individual, decedent's estate, or non-grantor trust.

One commenter supported the proposed definition of payor of record. This commenter requested confirmation that only one written statement per SPVL per year is required and acceptable, even if the loan has more than one borrower. The Treasury Department and the IRS confirm that as a result of the interaction between § 1.6050AA-1(b)(5) and (a)(2), when there are co-borrowers on an SPVL, only the payor of record is required to be furnished a written statement on the SPVL under § 1.6050AA-1(a)(2)(ii).

Another commenter requested clarification on what, if any, reporting obligations exist when the borrower is deceased at the time of the filing deadline. This commenter requested that the final regulations include guidance confirming that the interest recipient may rely on available public records, correspondence, or obligor account status indicators to determine whether to furnish a statement and that furnishing to the estate or co-obligor would satisfy the furnishing requirement.

No modifications are needed in the final regulations to the text used in proposed § 1.6050AA-1(b)(5). As a result of the interaction between § 1.6050AA-1(b)(5) and (a)(2), only the payor of record would be furnished a written statement on the SPVL under § 1.6050AA-1(a)(2)(ii). The payor of record on the SPVL can be a decedent's estate, and the death of the borrower does not eliminate the statutory reporting requirement.

C. *Reporting by a Foreign Person*

Under proposed § 1.6050AA-1(c)(1), an interest recipient that is a foreign person would be required to report with respect to interest received on an SPVL to the extent such interest is received at a location in the United States. Under proposed § 1.6050AA-1(c)(2), an interest recipient that is a foreign person and receives interest at locations outside the United States would be required to report only if the foreign person is a controlled foreign corporation (as defined in section 957(a) of the Code) or if 50 percent or more of the foreign person's gross income was effectively connected with the conduct of a trade or business within the United States.

One comment requested guidance regarding the information reporting obligations of foreign persons holding securitized interests in a vehicle loan. The Treasury Department and the IRS do not believe it is necessary to provide any additional clarification in response to this comment because foreign persons holding securitized interests in a vehicle loan with reporting obligations under section 6050AA are subject to the same requirements as domestic interest recipients holding securitized interests in a vehicle loan.

D. *Reporting with Respect to a Nonresident Alien Individual, Foreign Decedent's Estate, or Foreign Non-Grantor Trust*

Proposed § 1.6050AA-1(d)(1) provided that the reporting requirement of section 6050AA does not apply if the payor of record is a nonresident alien, foreign decedent's estate, or foreign non-grantor trust. Proposed § 1.6050AA-1(d)(2) provided the documentation rules that the interest recipient is required to follow to determine whether the payor of record is a nonresident alien individual, foreign decedent's estate, or foreign non-grantor trust.

Some commenters requested changes to proposed § 1.6050AA-1(d)(1) in the final regulations. One commenter requested specific language in the final regulations noting that the payor of record is presumed to be a U.S. person for section 6050AA purposes. Another commenter claimed that vehicle finance companies do not necessarily have data regarding the legal status of customers and requested that proposed § 1.6050AA-1(d)(2) and (3) be deleted in the final regulations so that finance companies are not required to determine the legal status of the payor of record.

The Treasury Department and the IRS understand the concern that vehicle finance companies may not currently have the documentation necessary to determine whether a particular payor of record is a nonresident alien individual, foreign decedent's estate, or foreign non-grantor trust. However, the documentation rules that the interest recipient is required to follow are similar to the longstanding rules applicable to nonresident alien individuals who pay mortgage interest in § 1.6050H-1(d)(2). Accordingly, the Treasury Department and the IRS decline to modify the reporting requirement of section 6050AA in the case of a payor of record that is a nonresident alien individual, foreign decedent's estate, or foreign non-grantor trust.

E. *Amount of Interest Received on an SPVL for the Calendar Year*

Under proposed § 1.6050AA-1(e), whether an interest recipient receives $600 or more of interest on an SPVL would be determined on an SPVL-by-SPVL basis. To make the regulations easier to read, the language in proposed § 1.6050AA-1(b)(2)(ii) (*De minimis rule*) and (e) (*Amount of interest received on SPVL for calendar year*) have been grouped together in new § 1.6050AA-1(f)(1) and (2), respectively, and new headings have been added to the paragraphs. The contents of proposed § 1.6050AA-1(e) have not been changed.

F. *Requirement to File an Information Return*

Section 6050AA(b) provides that the information return filed by the interest recipient must be in the form prescribed by the Secretary and must contain: (A) the name and address of the individual from whom such interest was received, (B) the amount of such interest received for the calendar year, (C) the amount of outstanding principal on the SPVL as of the beginning of such calendar year, (D) the date of origination of that loan, (E) the year, make, model, and VIN of the APV that secures that loan (or such other description of that vehicle as the Secretary may prescribe), and (F) any other information as the Secretary may prescribe.

Under proposed § 1.6050AA-1(f), the interest recipient would be required to file a form designated by the Secretary that contains: (i) the name, address, and taxpayer identification number of the payor of record; (ii) the name, address, and taxpayer identification number of the interest recipient; (iii) the amount of interest received for the calendar year; (iv) the amount of outstanding principal on the SPVL as of the beginning of such calendar year; (v) the date of origination of such loan; (vi) the year, make, model, and VIN of the APV that secures such loan; (vii) the date the SPVL was acquired; and (viii) any other information required by the form or its instructions.

Some commenters discussed the requirement to file an information return with the IRS. One commenter recommended allowing interest recipients to submit a single information return detailing all SPVL transactions for the reporting period. Another commenter noted the requirement to report the VIN, year, make, model, loan origination date, acquisition date, outstanding principal balances, and lien status would require system modifications. Other commenters claimed that interest recipients may experience difficulties accurately reporting the VIN. One commenter recommended that the final regulations provide a safe harbor for minor clerical errors in VIN reporting.

The Treasury Department and the IRS decline to change the requirement for interest recipients to file a return with the IRS for each SPVL, as this is expressly required by sections 6050AA(a) and 6724(d)(1)(B). The items in proposed § 1.6050AA-1(f) generally followed the items prescribed in section 6050AA(b)(2). The Treasury Department and the IRS understand that interest recipients may not currently track the VIN associated with the vehicle. Section 6050AA(b)(2)(E) requires the interest recipient to report the VIN of the APV that secures the loan on which interest is received. The Treasury Department and the IRS cannot modify this statutory requirement; in addition, an accurate VIN will enable the interest recipients and the IRS to verify other statutorily mandated information. See part III.B.1 of this Summary of Comments and Explanation of Revisions (*Applicable Passenger Vehicle (APV)*) for a discussion of how to determine if a vehicle is an APV.

One commenter requested clarification that the "date acquired" information ensures that the taxpayer can consolidate multiple information returns when there are multiple interest recipients for the same SPVL during the same calendar year. The Treasury Department and the IRS understand SPVLs may be sold or otherwise transferred to a new lender of record during the calendar year. The Treasury Department and the IRS confirm that the date acquired information provides the taxpayer with information regarding which period is covered by each information return rather than requiring consolidated reporting by multiple interest recipients.

G. *Requirement to Furnish a Written Statement*

Section 6050AA(c) provides that every person required to make an information return under section 6050AA(a) must also furnish to each individual whose name is required to be included in the return a written statement showing the name, address, and phone number of the information contact of the interest recipient, and the information required to be included in the information return under section 6050AA(b)(2)(B) through (F).

Proposed § 1.6050AA-1(g) would require the interest recipient that would be required to file a return under proposed § 1.6050AA-1(a) to furnish a statement to the payor of record. Under proposed § 1.6050AA-1(g), the recipient would be the payor of record and the written statement would be required to include the information that was reported on the form designated for this purpose. In addition, the written statement would be required to include a legend identifying the statement as important tax information that is being furnished to the IRS and stating that penalties may apply if the payor of record overstates a deduction for interest reported on the statement. Proposed § 1.6050AA-1(g)(2)(ii) would also require that the written statement include a legend stating that the payor of record may be unable to deduct the full amount of SPVL interest reported on the statement.

Several commenters claimed the interest recipients should not be required to furnish a written statement to the payor of record. In general, these commenters recommended allowing the interest recipient to provide the amount of interest received to the payor of record either on a monthly statement or via an online portal, similar to the requirements of Notice 2025-57. The Treasury Department and the IRS decline to change the requirement to furnish a statement to the payor of record, as this is expressly required by sections 6050AA(c) and 6724(d)(2)(MM).

Many commenters recommended that the Treasury Department and the IRS confirm that the taxpayer has the ultimate responsibility for determining whether and to what extent the taxpayer is able to claim the deduction allowed under section 163(h)(4). The Treasury Department and the IRS confirm the taxpayer has the ultimate responsibility for deductions claimed on the taxpayer's Federal income tax return. To minimize the risk of recipients claiming an interest deduction that is limited by section 163(h)(4)(C) or for which they are otherwise ineligible, the written statement must include a legend providing certain information.

Some commenters discussed the legend described in proposed § 1.6050AA-1(g)(2)(iii). One commenter stated that the legend is quite lengthy and might be improved if simplified. Two commenters expressed concern that the legend inappropriately deputizes the interest recipient as an enforcement authority or tax deduction eligibility auditor.

The Treasury Department and the IRS decline to make any changes to the legend in response to these comments. The legend described in § 1.6050AA-1(h)(2)(iii) is similar to the legend required on written statements reporting mortgage interest in § 1.6050H-2(b)(2)(ii) and (iii). The use of similar language is helpful to taxpayers and minimizes the risk of recipients being confused by any differences between the two forms. Finally, the legend reinforces the principle that it is the taxpayer who must make the final decision on whether and how much to claim as a deduction on the tax return.

One commenter recommended that an option to provide an electronic statement to the payor be added to the final regulations. Another commenter recommended that the final regulations clarify that the written statement can be sent in an electronic form if the payor of record has consented to receiving disclosures electronically under the Electronic Signatures in Global and National Commerce Act (E-SIGN Act), Public Law 106-229, 114 Stat. 464 (June 30, 2000).

The Treasury Department and the IRS decline to modify the rules regarding the electronic furnishing of certain payee statements because they are outside the scope of these regulations. The revenue procedure relating to electronic furnishing of certain payee statements is generally updated annually and is also reproduced as IRS Publication 1179, *General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, and Certain Other Information Returns*. See Rev. Proc. 2025-22, 2025-30 I.R.B. 200, and Publication 1179 published July 21, 2025. The Treasury Department and the IRS emphasize that interest recipients can utilize existing procedures for electronic furnishing of the payee statement. Interest recipients can also provide comments on Notice 2026-4, which requests comments on whether the Treasury Department and the IRS should modify the electronic furnishing requirements applicable to persons required to furnish payee statements. See Notice 2026-4, 2026-13 I.R.B. 726 (March 23, 2026).

H. *Transition Relief*

Several commenters recommended that the Treasury Department and the IRS extend the transition relief provided in Notice 2025-57. Other commenters recommended that the final regulations include a phased implementation timeline.

The OBBBA was signed into law on July 4, 2025. Section 163(h)(4), as amended, and new section 6050AA apply to indebtedness incurred after December 31, 2024. The statute provides for reporting related to indebtedness incurred prior to the enactment of the OBBBA. The Treasury Department and the IRS understand that recipients needed time to make the necessary changes to their systems to comply with their new information reporting responsibility under section 6050AA. In Notice 2025-57, the Treasury Department and the IRS provided transitional guidance with respect to the reporting obligations under section 6050AA with regard to interest that the recipient received on an SPVL in calendar year 2025. However, taxpayers need the information reported under section 6050AA to complete their personal income tax returns, and interest recipients will have had approximately 18 months from the enactment of the OBBBA to the time that they will need to begin reporting under section 6050AA. Therefore, the Treasury Department and the IRS are not including additional transitional guidance or phased implementation in the final regulations.

Some commenters requested penalty relief for good-faith efforts made by interest recipients or reasonable cause relief during the initial compliance period. Another commenter requested that the Treasury Department and IRS clarify whether reasonable cause relief would apply when the interest recipient lacks access to necessary data despite commercially reasonable efforts. In the refinance context, one commenter requested confirmation that an interest recipient would not be penalized for relying in good faith on its books and records for identifying the payor of record and the information available to it in connection with refinancing, including borrower attestations and payoff documentation from the prior lender.

Section 6721 imposes a penalty for any failure to file an information return on or before the required filing date, and for any failure to include all the information required to be shown on a return or the inclusion of incorrect information. Section 6722 imposes a penalty for any failure to furnish a payee statement on or before the required furnishing date to the person to whom such statement is required to be furnished, and for any failure to include all the information required to be shown on a payee statement or the inclusion of incorrect information. Section 6724(a) provides that no penalty may be imposed under sections 6721 and 6722 if it is shown that any such failure was due to reasonable cause and not willful neglect. The Treasury Department and the IRS have determined that providing additional safe harbors or reasonable cause relief is unnecessary in light of the statutory provision in section 6724(a).

One commenter requested clarification on the interaction between the applicability date included in the final regulations and Notice 2025-57. The Treasury Department and the IRS confirm that an interest recipient may satisfy the reporting obligations under section 6050AA for interest received in calendar year 2025 by satisfying the reporting obligations under section 6050AA for calendar year 2025 as described in Notice 2025-57.

I. *Miscellaneous*

A couple of commenters discussed recordkeeping requirements. One commenter requested additional clarification on the recordkeeping and reporting requirements for taxpayers. Another commenter recommended adding a specific record retention requirement for recipients of interest to the final regulations in § 1.6050AA-1.

Taxpayers are required to maintain records that are sufficient to enable the IRS to determine their correct tax liabilities. See section 6011 and § 1.6001-1(a). The Treasury Department and the IRS have determined that providing additional record retention requirements for taxpayers is both unnecessary and outside the scope of these regulations. With respect to the information returns required by section 6050AA, it is unnecessary to prescribe specific recordkeeping requirements because § 1.6050AA-1(g)(2) prescribes the information that must be reported by interest recipients.

IV. *Explanation of Revisions to Proposed §§ 301.6011-2, 301.6721-1, and 301.6722-1*

The final regulations include a revision to proposed § 301.6011-2 to reflect that Form 1098-VLI is used to report information required under section 6050AA. The final regulations also include revisions to proposed §§ 301.6721-1 and 301.6722-1 that are necessary as a result of correcting amendments to TD 9991, 91 FR 13220, published March 19, 2026. The language in proposed § 301.6721-1(j)(2) and (j)(2)(i) and proposed § 301.6722-1(g)(2) and (g)(2)(i) were published in the correcting amendments to TD 9991 and are not republished in the final regulations. The language in proposed § 301.6721-1(j)(2)(ii) has been moved to § 301.6721-1(j)(2)(iii). Second, the language in proposed § 301.6722-1(g)(2)(ii) has been moved to § 301.6722-1(g)(2)(iii). The contents of these provisions are not being revised in the final regulations.

Special Analyses

I. *Regulatory Planning and Review—Economic Analysis*

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

The final regulations have been designated by the Office of Management and Budget's (OMB's) Office of Information and Regulatory Affairs (OIRA) as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (MOA, July 4, 2025) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. OIRA has determined that the final rulemaking is significant under section 3(f)(1) of Executive Order 12866 and subject to review under Executive Order 12866 and section 1(b) of the MOA. Accordingly, the final regulations have been reviewed by OMB.

This final rule is expected to be an Executive Order 14192 regulatory action.

Need for Regulation

Section 70203 of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), amends section 163(h) of the Internal Revenue Code[2] to provide a newly allowable income tax deduction for qualified passenger vehicle loan interest (QPVLI). In the absence of regulations, taxpayers would face substantial uncertainty about which vehicle loan interest is eligible for the deduction. The OBBBA also establishes section 6050AA of the Code to require interest recipients receiving at least $600 of interest on a specified passenger vehicle loan (SPVL) within a calendar year to file an information return with the Internal Revenue Service (IRS) and furnish a statement to the payor of record. In the absence of guidance, interest recipients would face uncertainty about how to comply with the requirements.

The final regulations clarify the statute for taxpayers and lenders, including by: defining "personal use" and providing a standard for "personal use" of a vehicle; clarifying the requirements for interest to be QPVLI; clarifying the requirements for indebtedness to be an SPVL; defining "indebtedness incurred for the purchase of an applicable passenger vehicle" to include the cost of warranties, service plans, and other amounts customarily financed in a vehicle purchase transaction that are directly related to the purchased vehicle; establishing which information must be reported by lenders to comply with the information reporting requirements; clarifying that the deduction is limited to $10,000 per return, regardless of the taxpayer's filing status; providing rules for determining whether "final assembly" of a vehicle occurred in the United States; and offering further definitions and clarifications of terms in section 163(h)(4) and section 6050AA, such as the vehicle identification number (VIN).

I. The Statute and Final Regulations

Under section 163(h)(1), certain taxpayers cannot deduct personal interest paid or accrued during the taxable year. Section 70203(a) of the OBBBA adds a new section 163(h)(4) to the Code. Section 163(h)(4)(A) provides that, in the case of taxable years beginning after December 31, 2024, and before January 1, 2029, personal interest does not include QPVLI. This allows taxpayers to deduct QPVLI for taxable years beginning after December 31, 2024, and before January 1, 2029. Section 163(h)(4)(B) defines QPVLI as any interest that is paid or accrued during the taxable year on indebtedness incurred by the taxpayer after December 31, 2024, for the purchase of, and that is secured by a first lien on, an applicable passenger vehicle (APV) for personal use. Section 163(h)(4)(B) also includes exceptions to QPVLI, such as financing for commercial vehicles or lease financing, and a requirement for taxpayers to include the VIN of the APV on the tax return in order to claim the deduction.

The final regulations provide definitions and clarifications of terms related to QPVLI in section 163(h)(4) and section 6050AA. The final regulations clarify that individuals, decedents' estates, and non-grantor trusts may deduct QPVLI. The final regulations provide that interest is only QPVLI if the interest is paid or accrued during the taxable year on indebtedness that is an SPVL secured by a first lien on an APV and is not otherwise excluded from the definition of QPVLI. The final regulations adopt a standard for personal use that provides that a taxpayer is considered to purchase an APV for personal use if, at the time the indebtedness is incurred, the taxpayer expects that the APV will be used for personal use by the taxpayer, the taxpayer's spouse, or an individual that is related to the taxpayer within the meaning of section 152(c)(2) or (d)(2) of the Code, or any combination of these individuals, for more than 50 percent of the time the taxpayer expects to own the APV. The 50 percent threshold is intended to correspond to a vehicle being predominantly used for "personal use" within the meaning of section 163(h)(4)(B)(i) while still allowing taxpayers with considerable non-personal use to benefit from the deduction. If the taxpayer is a decedent's estate or non-grantor trust, personal use is tested based on the use by legatees or heirs, or beneficiaries, respectively. Further, under the final regulations, the taxpayer is not required to reevaluate compliance with the personal use standard in taxable years after the indebtedness is incurred. The final regulations also clarify that taxpayers may not deduct the same interest as both QPVLI and otherwise deductible interest (such as a business interest expense) and that taxpayers must report certain information relating to vehicle interest deducted independent of QPVLI.

[2] References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (Code), unless otherwise indicated.

Typical auto loan sales contracts indicate an “amount financed” that may include property and services in addition to the amount for the price of the vehicle. The final regulations provide that indebtedness incurred for the purchase of an APV as well as for certain items or amounts customarily financed in an APV purchase transaction that are directly related to the purchased APV is an SPVL and therefore interest paid or accrued on such indebtedness is potentially eligible to be deducted. The final regulations describe certain items and services that are considered customarily financed in an APV purchase transaction that are directly related to the purchased APV, such as vehicle service plans, extended warranties, sales taxes, and vehicle-related fees. Indebtedness not incurred for the purchase of an APV nor for any other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchased APV is not an SPVL, and, therefore, interest paid or accrued on such indebtedness is not QPVLI. For example, to the extent that a taxpayer incurs indebtedness to purchase collision and liability insurance that is not a credit insurance product or to purchase any property or services unrelated to the vehicle (for example, a trailer or a boat), that indebtedness is not an SPVL, and, therefore, interest paid or accrued on that indebtedness is not QPVLI.

Section 163(h)(4)(C) establishes limitations on the amount of QPVLI that a taxpayer may deduct. The dollar limit is $10,000 per taxable year. The final regulations clarify that this limit applies regardless of the taxpayer’s filing status for that taxable year. Additionally, under section 163(h)(4)(C)(ii)(I), the deduction for QPVLI is reduced (but not below zero) by $200 for each $1,000 (or portion thereof) by which the taxpayer’s modified adjusted gross income (MAGI) exceeds $100,000 ($200,000 in the case of a married couple filing a joint return). Section 163(h)(4)(C)(ii)(II) defines “modified adjusted gross income” for the purposes of this phaseout as adjusted gross income of the taxpayer for the taxable year plus any amount excluded from gross income under sections 911, 931, or 933 of the Code. The final regulations clarify that for estates and non-grantor trusts, the MAGI phaseout is applied to the estate or trust, not with respect to the beneficiaries of the estate or trust; and for estates and non-grantor trusts, MAGI means AGI as defined in section 67(e) of the Code.

Section 163(h)(4)(D) defines the term “applicable passenger vehicle.” The criteria for an APV include that its original use must commence with the taxpayer and that its final assembly must have occurred in the United States. The final regulations provide rules for determining whether original use of a vehicle begins with the taxpayer, rules for whether a vehicle’s final assembly occurred in the United States, and definitions for other APV-related terms used in the statute. Original use generally commences with the first person that takes delivery of a vehicle after the vehicle is sold, registered, or titled. For purchasers that incur indebtedness to purchase a vehicle, original use does not commence with the taxpayer unless the loan documentation treats the vehicle as a new vehicle. The final regulations provide that taxpayers can determine the location of final assembly by (1) the plant of manufacture as reported in the VIN or (2) the final assembly point reported on the label affixed to the vehicle.

Section 163(h)(4)(E) provides other definitions and special rules. These include the treatment of refinancing and of indebtedness owed to related parties. The final regulations clarify that for refinanced loans, the amount of the new loan on which interest may be considered QPVLI is limited to the outstanding balance of the refinanced loan as of the date of the refinancing.

Section 70203(b) of the OBBBA amends section 63(b) of the Code so that the deduction for QPVLI is allowed for taxpayers who do not elect to itemize their deductions. The final regulations clarify that the deduction is available to taxpayers who itemize their deductions and to taxpayers who claim the standard deduction.

Section 70203(c) of the OBBBA adds a new section 6050AA to the Code that establishes information reporting requirements for vehicle loan interest. Any person who, in the course of a trade or business, receives from any individual more than $600 in a calendar year on an SPVL must provide an information return to the IRS and furnish a statement to the payor of record. The final regulations provide operational definitions and rules for complying with the information reporting requirements. The final regulations clarify the need to report the date the SPVL was acquired; require that the statement to the payor of record includes a legend clarifying that the taxpayer may be unable to deduct the full amount of interest shown on the statement; and offer guidance on reporting by and to certain foreign persons. To prevent duplicate reporting, the final regulations also provide that if an interest recipient’s records for a loan do not indicate which borrower is the principal borrower, the interest recipient must designate a principal borrower. This follows established practice with respect to information reporting requirements for qualified residence interest.

II. Baseline

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

III. Affected Entities and Taxpayers

The final regulations affect individuals, decedents’ estates, and non-grantor trusts that may deduct QPVLI, and also affect any person engaged in a trade or business, who, in the course of that trade or business, receives interest aggregating $600 or more for any calendar year on an SPVL and is therefore subject to certain information reporting requirements. As described in the preamble to the final regulations, interest recipients receiving less than $600 of interest on an SPVL have the option to provide information returns.

Under section 163(h)(4), the deduction is limited to interest on loans for vehicles with final assembly occurring in the U.S. whose original use commences with the taxpayer. The Treasury Department and the IRS estimate that in 2024, roughly 6 million loans originated on new U.S.-assembled vehicles. See Table

A. Retail sales of new light vehicles in the U.S. totaled about 16 million in 2024[3]; roughly 60 percent of new vehicle purchases are financed with loans[4]; and analysis of vehicle model sales data suggests that about 60 percent of vehicles sold in the U.S. undergo U.S. final assembly. The Treasury Department and the IRS do not have an estimate of the number of decedents' estates and non-grantor trusts that are obligors on vehicle loans.

Table A: Estimated Annual Loans on New U.S.-assembled Vehicles	
1. 2024 U.S. new light vehicle sales	16 million
2. Share of new vehicle sales financed with loans	60 percent
3. Of new vehicles sold, share with U.S. final assembly	60 percent
4. Estimated annual loans on new vehicles with U.S. final assembly	Approximately 6 million

Notes: Row 4 is the rounded product of rows 1, 2, and 3.
Sources: "Light vehicle retail sales in the United States from 1976 to 2024," Statista, last accessed October 27, 2025, https://www.statista.com/statistics/199983/us-vehicle-sales-since-1951/; https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles; "New and used passenger car and light truck sales and leases," Bureau of Transportation Statistics, last accessed October 27, 2025, https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles; "State of the Automotive Finance Market Report: Q2 2025," Experian, last accessed October 27, 2025, https://www.experian.com/automotive/auto-credit-webinar-form; manufacturer vehicle model sales data.

To identify the number of businesses that the final regulations are expected to affect, the Treasury Department and the IRS analyzed confidential tax return data. For tax year 2023, approximately 36,000 businesses filed a tax return with North American Industry Classification System (NAICS) codes for new car dealers (code 441110), motorcycle dealers (code 441227), car loan lenders (code 522220), and consumer lending (code 522291). See Table B. This total does not include used car dealers because the statute and regulations only apply to loans for new vehicles.

Table B: Estimated Number of Affected Businesses by NAICS Code	
New car dealers (441110)	17,800
Motorcycle dealers (441227)	4,100
Car loan lenders (522220)	5,800
Consumer lending (522291)	8,100
Total	35,800

Notes: The table shows counts of tax year 2023 filers of forms 1065, 1120S, or 1120. NAICS codes appear in parentheses.
Source: Treasury Department analysis of confidential tax return data, October 24, 2025.

IV. Economic Effects of the Final Regulations

The final regulations clarify the statute and facilitate taxpayers claiming the QPVLI deduction. Consider, for example, a taxpayer who is purchasing a vehicle. For most people, a vehicle is a major purchase, and there are many elements to be considered along the way, including choices between a new versus used vehicle, a U.S.-assembled versus foreign-assembled vehicle, and a cash purchase versus a loan or a lease. With the introduction of the deduction for QPVLI, the taxpayer now faces questions about whether and how the statute interacts with the vehicle and financing choices they make. For instance, in the absence of guidance, the taxpayer may not know whether their expected personal use of the vehicle is sufficient to claim the deduction or whether a vehicle meets the standard for U.S.-final assembly.

The final rules assist the taxpayer in understanding and claiming the QPVLI deduction. For example, the final regulations direct taxpayers to the National Highway Traffic Safety Administration (NHTSA) VIN Decoder website to determine whether a vehicle underwent final assembly in the United States, a necessary condition for the vehicle loan interest to be eligible for the deduction. By facilitating taxpayers' understanding of which vehicles are American made and an APV under the statute, the final regulations reduce taxpayer compliance burden and, as a result, may also increase consumer

[3] "Light vehicle retail sales in the United States from 1976 to 2024," Statista, last accessed October 27, 2025, https://www.statista.com/statistics/199983/us-vehicle-sales-since-1951/; https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles; "New and used passenger car and light truck sales and leases," Bureau of Transportation Statistics, last accessed October 27, 2025, https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles. The 16 million total transactions (row 1 of Table A) includes leases; the share of new vehicle transactions financed with a loan (row 2 of Table A), used to estimate the number of loans on new U.S.-assembled vehicles, excludes leases.

[4] "State of the Automotive Finance Market Report: Q2 2025," Experian, last accessed October 27, 2025, https://www.experian.com/automotive/auto-credit-webinar-form; "New and used passenger car and light truck sales and leases," Bureau of Transportation Statistics, last accessed October 27, 2025, https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles.

demand for APVs and SPVLs, namely loans for new U.S.-assembled vehicles. The Treasury Department and the IRS do not have readily available parameters and models to quantify the extent of this increase in demand for U.S. assembled vehicles or debt financing. The following sections describe in further detail the potential economic impacts of specific elements of the final regulations

a. Personal Use Standard

Section 163(h)(4) limits the deduction to vehicles purchased for personal use. The final regulations provide a standard for personal use. To meet the standard, the taxpayer must expect at the time of purchase that the APV will be used for personal use for more than 50 percent of the time the taxpayer expects to own the APV. An alternative standard of personal use could have required mostly or exclusively personal use of a vehicle for loan interest to be considered QPVLI.

The 50 percent personal use standard benefits taxpayers who debt-finance mixed-use vehicles who would be disallowed from taking the deduction for QPVLI under stricter, alternative standards. Interest on a vehicle loan that is properly allocable to a trade or business is generally deductible under section 163(a). Consider, for example, a taxpayer who finances the purchase of an APV expecting for 60 percent of use to be for personal use and 40 percent for use in a trade or business. Assume for a given tax year the taxpayer pays $3,500 in interest on the vehicle loan, drives the vehicle 55 percent for personal use and 45 percent for use in a trade or business, and meets all other requirements to deduct QPVLI and interest properly allocable to a trade or business. (Note that 55 percent personal use for this tax year differs somewhat from the taxpayer's expected 60 percent personal use over the cumulative time the taxpayer expects to own the vehicle.) Under a strict personal use standard for QPVLI, such as exclusive personal use, the taxpayer would be prohibited from deducting any interest as QPVLI, and would only be able to deduct the interest attributable to use in a trade or business ($1,575, equal to 45 percent of the $3,500 of interest paid during the year), provided all of the other requirements for deducting interest properly allocable to a trade or business are met. Under the 50 percent personal use standard, the taxpayer can potentially deduct all $3,500 in interest as QPVLI. Alternatively, the taxpayer would have discretion to deduct $1,575 (45 percent of $3,500) as interest properly allocable to a trade or business and $1,925 as QPVLI ($3,500 minus $1,575). The 50 percent personal use standard benefits taxpayers with mixed-use vehicles who, under a strict personal use standard, would be able to deduct only interest properly allocable to a trade or business.

The Treasury Department and the IRS examined public survey data and confidential tax records to assess the prevalence of mixed-use vehicles that may be affected by the personal use standard. Analysis of Panel Study of Income Dynamics (PSID) data suggests that, in 2023, 11 percent of personally owned vehicles were used for mixed personal and business purposes.[5] An alternative and narrower standard of personal use, such as exclusive personal use, would exclude roughly 700,000 loans (11 percent of the estimated 6 million total shown in Table A) from potential eligibility for the QPVLI deduction. See Table C.

Table C: Estimated Annual Loans on New U.S.-assembled Vehicles for Mixed Personal and Business Use	
1. Estimated annual loans on new U.S.-assembled vehicles	6 million
2. Share of personally owned vehicles used for mixed personal and business purposes	11 percent
3. Estimated annual loans on new U.S.-assembled vehicles for mixed personal and business use	Approximately 700,000
Notes: Row 3 is the rounded product of rows 1 and 2. Sources: Row 2 is derived from the 2023 Panel Study of Income Dynamics, variable ER82936. Row 1 is derived in Table A, with data sourced from: "Light vehicle retail sales in the United States from 1976 to 2024," Statista, last accessed October 27, 2025, https://www.statista.com/statistics/199983/us-vehicle-sales-since-1951/; https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles; "New and used passenger car and light truck sales and leases," Bureau of Transportation Statistics, last accessed October 27, 2025, https://www.bts.gov/content/new-and-used-passenger-car-sales-and-leases-thousands-vehicles; "State of the Automotive Finance Market Report: Q2 2025," Experian, last accessed October 27, 2025, https://www.experian.com/automotive/auto-credit-webinar-form; manufacturer vehicle model sales data.	

Tax records also contain information on mixed personal and business use vehicles. Sole proprietors file Schedule C to record business income and expenses, including car or truck expenses. On part IV of Schedule C, certain taxpayers are required to enter information on their vehicle, including the date a vehicle was placed in service for business purposes; the number of miles driven for business, commuting, and other purposes; and whether the vehicle was available for personal use during off-duty hours.[6]

Schedule C data has several limitations for analysis of the personal use standard. First, Schedule C does not distinguish between new versus used cars, U.S.- versus foreign-assembled cars, or cars financed with loans versus cars that are leased or purchased with cash. Because sole proprietors will not have an SPVL as a result of the purchase of used cars or foreign-assembled cars, nor as a result of the cash purchase or lease of any cars,

[5] See variable ER82936 in the 2023 PSID. The survey language is: "Not counting routine use to get to and from work, is this vehicle also used for business purposes?"

[6] Taxpayers are required to fill out part IV of Schedule C only if they claim car or truck expenses on Schedule C and are not required to file Form 4562, *Depreciation and Amortization*, for the business in question. Taxpayers who have "listed property," including automobiles, are required to enter information on such automobiles in Section B of Part V of Form 4562.

totals of mixed-use vehicles from part IV of Schedule C overstate the number of sole proprietors' vehicles that the personal use standard will affect. Second, the data available for analysis cover predominantly electronically filed returns of Schedule C rather than paper filed returns. Third, the Schedule C data do not include vehicle expenses that taxpayers may deduct on Schedules E and F. Fourth, the Schedule C data indicate when the car was placed into service for business use rather than when the individual first acquired the car. The available Schedule C data nonetheless provide insight on the prevalence of personal use of sole proprietors' business vehicles.

The Treasury Department and the IRS estimate that in tax year 2023, sole proprietors who filed electronically placed 5 million vehicles in service for business purposes.[7] See Table D. About 80 percent of these taxpayers indicated that the vehicle was also available for personal use during off-duty hours. Among filers for whom the vehicle was available for personal use, roughly 40 percent drove the vehicle more than 50 percent of its total mileage for personal use. The typical filer drove the vehicle for majority business use; the median share of total miles driven for business purposes was about 80 percent. These estimates suggest that a substantial share of taxpayers with vehicles for business use would benefit from the 50 percent personal use standard, relative to a strict alternative standard, such as exclusive personal use.

Table D: Statistics on Tax Year 2023 Sole Proprietor Vehicle Use from Schedule C, Part IV	
1. Sole proprietors' vehicles placed in business service in tax year 2023*	5 million
2. Of vehicles placed in business service in tax year 2023 (row 1), the share reported to be available for personal use	80 percent
3. Of vehicles placed in business service in 2023 and available for personal use, the share reported with more than 50 percent of mileage for personal use.	40 percent
4. Of vehicles placed in business service in 2023 and available for personal use, the median share of miles driven for business use.	80 percent
* This total does not correspond to vehicles that are APVs; it includes used, leased, and foreign-assembled vehicles, which are not APVs. See the text for further detail on the Schedule C data and its limitations. Source: Treasury Department analysis of confidential tax return data, October 24, 2025.	

The personal use rules also benefit taxpayers by providing clarity. In the absence of a personal use standard, two taxpayers with otherwise similar tax situations would face uncertainty as to whether this deduction applies to their situation. Without guidance, these taxpayers might make different choices as to whether their vehicle loan interest qualifies for the deduction, and, therefore, face different tax liabilities. Consider, for example, two taxpayers who each buy an APV expecting for 75 percent of its use to be for personal use and 25 percent for business use (assume they meet all other requirements to claim the deduction). Taxpayer A interprets the section 163(h)(4) personal use requirement to mean that interest on the loan is not QPVLI, because the vehicle is partly for business use. In contrast, Taxpayer B interprets the personal use requirement to mean that interest on the loan is QPVLI because a majority of the use of the vehicle is for personal use. The final regulations ensure that these two taxpayers use the same standard of personal use and are subject to the same tax treatment.

The personal use standard, relative to a stricter alternative standard, may change vehicle purchase patterns among taxpayers who use their vehicles for mixed personal and business purposes (vehicles on which loan interest would not be considered QPVLI under a strict personal use standard). For this population, the 50 percent personal use standard would increase the economic appeal of financing relative to cash purchases and would increase the economic appeal of new U.S.-assembled vehicles relative to used or foreign-assembled vehicles. The extent of consumption changes along these margins depends on several interacting factors, including: the extent to which increased demand for new U.S.-assembled vehicles driven by the deduction affects the prices of these vehicles; substitution elasticities between new and used vehicles and between vehicles assembled in the U.S. and assembled abroad[8]; the salience of the tax deduction at the time of purchase[9]; and the extent to which taxpayers perceive the deduction as temporary, as prescribed in statute, or likely to be extended by future policymakers. The Treasury Department and the IRS do not have readily available parameters and models to precisely assess the impact. House Budget Committee Report 119-106 expects the deduction to promote domestic manufacturing.

[7] The 5 million total reflects sole proprietorship-vehicle pairs. A sole proprietor who placed the same vehicle in service for multiple businesses in 2023 would appear more than once in this total. Because Schedule C does not include a VIN or other unique vehicle identifier, Treasury and the IRS cannot distinguish these cases—the same vehicle placed in service for multiple businesses—from cases in which a sole proprietor placed multiple vehicles in service for multiple businesses.

[8] There is limited evidence on elasticities relating directly to the country of vehicle assembly. See Grieco et al. (2024) for estimates on consumer responsiveness to price changes across vehicle manufacturers. Grieco, Paul L.E., Charles Murry, and Ali Yurukoglu. 2024. "The Evolution of Market Power in the U.S. Automobile Industry." *The Quarterly Journal of Economics* 139 (2): 1201-1253, https://academic.oup.com/qje/article-abstract/139/2/1201/7276495?redirectedFrom=fulltext.

[9] Chetty, Raj, Adam Looney, and Kory Kroft. 2009. "Salience and Taxation: Theory and Evidence." *American Economic Review* 99 (4): 1145-77, https://www.aeaweb.org/articles?id=10.1257/aer.99.4.1145.

b. Personal Use Determined Soley by Taxpayer Expectation at Time Debt is Incurred

The final regulations provide that personal use is determined only once, based on taxpayers' expectation at the time indebtedness is incurred. An alternative standard could have required taxpayers to evaluate their expected use each year or document personal use each year to continue to qualify for the deduction. A repeated certification requirement would result in considerable compliance burden to taxpayers, particularly among taxpayers whose vehicles will be exclusively for personal use. The final regulations would benefit taxpayers by simplifying the process of claiming the QPVLI deduction, relative to a requirement for annual certification of sufficient personal use.

c. Personal and Business Use Allocation

Under the final regulations, if a taxpayer meets the personal use standard (more than 50 percent of expected use of an APV for personal use), the vehicle loan may be considered an SPVL. Alternative guidance could have required taxpayers to allocate amounts of loan interest attributable to personal and business uses of the APV and allowed only interest directly linked to personal use to be deducted. The final rules streamline the process and reduce the compliance burden of deducting QPVLI for taxpayers and administering the deduction for the IRS. Many taxpayers with mixed personal and business use vehicles already track and allocate personal and business mileage for Federal income tax purposes. For these taxpayers, the final regulations promote flexibility by allowing taxpayers who meet the personal use standard and all other requirements to deduct vehicle loan interest solely as QPVLI or, to the extent the taxpayers have interest properly allocable to a trade or business, as a business expense.

d. Specified Passenger Vehicle Loan (SPVL) and Further Definitions

The final regulations clarify what constitutes an SPVL. Specifically, the final rules provide that indebtedness qualifies as an SPVL only if the indebtedness is incurred for the purchase of an APV and for items and amounts customarily financed in an APV purchase transaction that are directly related to the purchased APV. These items include vehicle service plans, extended warranties, and sales taxes and vehicle-related fees. Indebtedness incurred for collision and liability insurance or to purchase any property or services unrelated to the APV (for example, a trailer or a boat) is not considered an SPVL. The final regulations strengthen the incentive for debt financing of the items and amounts included in the SPVL definition (such as warranties and sales taxes), relative to a rule that excluded those items and amounts from the SPVL definition.

Alternative guidance could have prescribed that only debt directly attributable to the price of the vehicle is an SPVL and therefore that only interest on that portion of the loan is deductible. Such an alternative standard could result in substantial compliance costs to taxpayers and to lenders and interest recipients in requiring allocations of indebtedness and associated interest. For amounts customarily financed together, such as the price of the vehicle itself and sales taxes and warranties on the vehicle, identifying and allocating which interest is attributable to which portion of total indebtedness would be difficult and costly to administer. The guidance benefits taxpayers by removing uncertainty and reduces burden relating to what taxpayers may consider an SPVL. According to Autotrader, for financed vehicle purchases, "taxes and dealer fees are almost always included in the payment."[10] A substantial share of taxpayers with QPVLI would therefore benefit from the SPVL definition, relative to an alternative definition that would require taxpayers to identify separately interest attributable to the price of the vehicle and items and amounts customarily financed with the vehicle. Relatedly, an SPVL definition limited strictly to the price of the vehicle may also require additional information reporting that burdens interest recipients and lenders. The SPVL definition benefits entities subject to information reporting requirements because taxpayers can determine their QPVLI without needing information on interest amounts related to the price of the vehicle separate from interest amounts related to items and amounts customarily financed with the vehicle.

II. *Paperwork Reduction Act*

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

The collection of information in these regulations contains reporting and recordkeeping requirements. The recordkeeping requirements mentioned in the final regulations are considered general tax records under § 1.6001-1(e). These records are required for the IRS to validate that taxpayers have met the regulatory requirements and are entitled to the deduction for QPVLI under section 163(a) and (h)(4) and to verify the amount of the deduction claimed. For PRA purposes, general tax records are already approved by the OMB under 1545-0074 for individuals and 1545-0092 for trust and estate filers.

The final regulations also mention reporting requirements related to claiming the deduction for QPVLI under section 163(a) and (h)(4). These collections will be made by eligible taxpayers as part of filing a return (such as the appropriate Form 1040 or 1041), including filling out the relevant schedules. These forms are approved by the OMB under 1545-0074 for individuals and 1545-0092 for trust and estate filers.

The final regulations also include reporting, third-party disclosure, and recordkeeping requirements required under section 6050AA as set forth in § 1.6050AA-1. These collections of information will be used by the IRS for

[10] "Are taxes and fees included in car financing?", Autotrader, last accessed October 28, 2025, https://www.autotrader.com/car-shopping/financing-a-car-are-taxes-and-fees-included-in-financing-222154.

tax compliance purposes and by taxpayers to help calculate their deduction. The burden associated with these information collections is included within the Form and Instructions for Form 1098-VLI. The Form 1098-VLI has been approved by the OMB, in accordance with 5 CFR 1320.10, under OMB control number 1545-2334.

No public comments were received by the IRS directed specifically at the PRA, but comments were received by the IRS on the proposed information collection and proposed reporting requirements and the burdens associated with the documentation requirements contained in the proposed regulations. As described in the relevant portions of this preamble, the Treasury Department and the IRS have determined that the documentation requirements are necessary to administer section 163(h)(4) and related information reporting and penalty provisions.

Many commenters requested that the Treasury Department and the IRS consider the time and cost for interest recipients to make adjustments to their systems to capture required data. The Treasury Department and the IRS acknowledge and appreciate that interest recipients may need to make adjustments to their systems and current processes to capture the required data. However, as a result of the interaction between sections 6050AA and 163(h)(4), certain information such as determining whether a vehicle is an APV and whether the interest is received on an SPVL, is required by statute. See parts III.B.1 and III.B.5 of the Summary of Comments and Explanation of Revisions (*Applicable Passenger Vehicle (APV)* and *Specified Passenger Vehicle Loan (SPVL)*, respectively) for a discussion of these requirements. The Treasury Department and the IRS have not changed the estimated burden of this reporting because commenters did not provide information relating to the additional costs associated with this reporting.

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

III. *Regulatory Flexibility Act*

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and that are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposal will not have a significant economic impact on a substantial number of small entities, section 604 of the RFA requires the agency to present a final regulatory flexibility analysis (FRFA) of the final regulations.

The Treasury Department and the IRS have determined the final regulations will likely have a significant impact on a substantial number of small entities. Accordingly, an FRFA is provided in the final regulations.

A. *Need for and Objectives of the Rule*

The final regulations provide the eligibility rules and key definitions regarding the QPVLI deduction, the deduction allowed by section 163(h)(4), to allow taxpayers to determine whether their interest is QPVLI. In addition, the final regulations provide the operational, administrative, and definitional rules for persons in a trade or business to comply with the statutory information reporting requirements under section 6050AA with interest received on an SPVL.

Congress intended the OBBBA provision regarding the QPVLI deduction to ease the financial burden of car ownership for individuals and promote domestic manufacturing. See House Budget Committee report on the OBBBA, H. Rept. 119-106, at 1510 (2025). The final regulations are intended to facilitate the easing of the financial burden of car ownership by providing the information necessary for taxpayers to claim the deduction. Additionally, the final regulations are consistent with the promotion of domestic manufacturing. The rules direct taxpayers to the NHTSA VIN lookup tool to help taxpayers and interest recipients determine whether a vehicle had undergone final assembly in the United States, a necessary condition for the vehicle to be an APV. Because the final regulations assist taxpayers claiming the deduction, the rules may also increase consumer demand for vehicles with final assembly in the United States. Over time, this may lead manufacturers to increase production and assembly of vehicles in the United States in order to meet demand for vehicles that are eligible to be APVs. Thus, the Treasury Department and the IRS intend and expect that the final regulations will deliver benefits across the economy that will favorably impact individuals, vehicle dealers, and the domestic manufacturing industry, including vehicle manufacturers.

Section 6050AA establishes information reporting requirements with respect to interest received on an SPVL. Information reporting under section 6050AA will provide taxpayers with information needed to claim the QPVLI deduction. The final regulations are expected to facilitate the preparation of tax returns and reduce the number of inadvertent errors by taxpayers who claim the deduction. The Treasury Department and the IRS also intend and expect that the final regulations will provide certainty to interest recipients required to comply with the statutory reporting requirements under section 6050AA.

B. *Significant Issues Raised by Public Comments in Response to the Initial Regulatory Flexibility Analysis*

No public comments were received by Treasury and the IRS that directly addressed the initial regulatory flexibility analysis of the proposed regulations, but comments were received by the IRS on the general burdens associated with the proposed information collection, proposed reporting requirements, and documentation requirements contained in the proposed regulations. Some commenters referenced the entity size of specific interest recipients, including credit unions, and stated that these interest recipients do not currently track all the information necessary to comply with the proposed regulations. As described in the relevant portions of this preamble, the Treasury Department and the IRS have determined that the requirements included in the final regulations are necessary to administer section 163(h)(4) and related information reporting and penalty provisions. The Treasury Department and the IRS also have determined that the statutory language does not authorize or support separate information reporting requirements for small entities.

C. *Affected Small Entities*

The RFA directs agencies to provide a description of, and if feasible, an estimate of, the number of small entities that may be affected by the final regulation. The Small Business Administration estimates in its 2023 Small Business Profile that 99.9 percent of United States businesses meet its definition of a small business. The applicability of the final regulations does not depend on the size of the business, as defined by the Small Business Administration. Small Business Administration regulations provide small business size standards by NAICS Industry. See 13 CFR 121.201.

As described more fully in this preamble to the final regulations and in this FRFA, these rules may affect a variety of different businesses across several different industries but will primarily affect dealers of new vehicles and financial entities that would be required to file and furnish information returns under section 6050AA. The NAICS includes dealers of new vehicles and financial entities in NAICS codes for new car dealers (code 441110), motorcycle dealers (code 441227), car loan lenders (code 522220), and consumer lending (code 522291).

Based on confidential tax return data, the Treasury Department and the IRS expect approximately 36,000 businesses to issue information returns under section 6050AA. See part I.III of this Special Analysis (*Affected Entities and Taxpayers*). This total does not include used car dealers because the statute and final regulations only apply to loans for new vehicles. Of the estimated 36,000 car and motorcycle loan lenders, the Treasury Department and the IRS expect 24,600 would likely be considered a small entity.

D. *Impact of the Rules*

The final regulations will increase the recordkeeping and reporting requirements for businesses that provide loans for new cars and motorcycles. Although the Treasury Department and the IRS do not have sufficient data to precisely determine the likely extent of the increased costs of compliance, the estimated burden of complying with the recordkeeping and reporting requirements are described in part II of this Special Analyses (*Paperwork Reduction Act*). Based on the estimated number of responses (8,000,000) and the estimated time to respond of 0.25 hours, the estimated burden is 2,000,000 total annual burden hours.

E. *Alternatives Considered for Small Businesses*

The Treasury Department and the IRS considered several alternatives to the final regulations that would have reduced the burden on small businesses. For example, the Treasury Department and the IRS considered a delay for reporting by small businesses. Although this would ease the burden on small businesses, it would increase the burden on individuals who need the information reported under section 6050AA to accurately claim the deduction for QPVLI on their Federal income tax returns. Accordingly, as discussed in part III.H of the Summary of Comments and Explanation of Revisions (*Transition Relief*), the Treasury Department and the IRS decided not to delay reporting under section 6050AA.

Another alternative considered was whether interest recipients should not be required to furnish a written statement to the payor of record and be permitted instead to provide this information to the payor of record either on a monthly statement or via an online portal. However, as discussed in part III.G of the Summary of Comments and Explanation of Revisions (*Requirement to Furnish a Written Statement*), the requirement to furnish a statement to the payor of record is expressly required by sections 6050AA(c) and 6724(d)(2)(MM).

IV. *Section 7805(f)*

Pursuant to section 7805(f), the proposed regulations (REG-113515-25) preceding this final regulation were 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.

V. *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 (updated annually for inflation). The final 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.

VI. *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 final 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.

VII. *Congressional Review Act*

Pursuant to the Congressional Review Act (5 U.S.C. 801 *et seq.*), the Office of Information and Regulatory Affairs designated this rule as a major rule, as defined by 5 U.S.C. 804(2).

Statement of Availability of IRS Documents

Guidance cited in this preamble is published in the Internal Revenue Bulletin and is available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at https://www.irs.gov.

Drafting Information

The principal author of these regulations is Riston Escher, Office of the Associate Chief Counsel (Income Tax & Accounting), IRS. 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 301

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

Amendments to the Regulations

Accordingly, the Treasury Department and IRS amend 26 CFR parts 1 and 301 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order for § 1.6050AA-1 to read in part as follows:

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

* * * * *

Section 1.6050AA-1 is also issued under 26 U.S.C. 6050AA(e).

* * * * *

Par. 2. Section 1.163-16 is added to read as follows:

§ 1.163-16 Qualified passenger vehicle loan interest.

(a) *Overview*—(1) *In general*. In computing the taxable income for a taxable year beginning after December 31, 2024, and before January 1, 2029, of a taxpayer described in paragraph (a)(2) of this section, for purposes of the deduction allowable under section 163(a) of the Internal Revenue Code (Code) , section 163(h)(4) excludes qualified passenger vehicle loan interest (QPVLI), from the definition of *personal interest* paid or accrued during the taxable year for which a deduction would be disallowed under section 163(h)(1). See paragraph (b) of this section for definitions of terms used in section 163(h)(4) and this section.

(2) *Taxpayers that may deduct QPVLI*—(i) *In general*. Only a taxpayer that is an individual, decedent's estate, or non-grantor trust may deduct QPVLI in computing the taxpayer's taxable income.

(ii) *Deduction available without regard to whether the taxpayer itemizes deductions*. Under section 63(b)(7) of the Code, the deduction for QPVLI allowable under section 163(h)(4) may be taken by a taxpayer without regard to whether the taxpayer itemizes deductions or takes the standard deduction.

(b) *Definitions*. The following definitions apply for purposes of section 163(h)(4) and this section:

(1) *Applicable passenger vehicle (APV)*. The term *applicable passenger vehicle* or *APV* means a vehicle that satisfies the requirements of paragraph (e)(1) of this section.

(2) *Dealer*. The term *dealer* means a person licensed by a State, the District of Columbia, the Commonwealth of Puerto Rico, any other territory or possession of the United States, an Indian Tribal government (as defined in section 7701(a)(40) of the Code), or an Alaska Native Corporation (as defined in section 3 of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m)) to engage in the sale of vehicles. This term includes a dealer licensed by any jurisdiction that makes sales at sites outside of the jurisdiction in which it is licensed.

(3) *Final assembly*. The term *final assembly* means the process by which a manufacturer produces a vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle.

(4) *Grantor trust*. A *grantor trust* is any portion of a trust that is treated as being owned by one or more persons under sections 671 through 679 of the Code.

(5) *Independently deductible interest*. The term *independently deductible interest* means interest that satisfies the requirements of paragraph (g)(1) of this section.

(6) *Items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV*. The term *items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV* means any item or amount that is customarily financed in an APV purchase transaction, and that is directly related to the purchase of the APV, as determined on an industry-wide basis and not by reference to the financing terms of a particular financing entity.

(7) *Lease financing*. The term *lease financing* means a transaction that is not a purchase of an APV, and under which a taxpayer has usage rights with respect to an APV but is not considered the owner of the APV under State or other applicable law.

(8) *Modified adjusted gross income*—(i) *Individuals*. The term *modified adjusted gross income*, in the case of an individual, means adjusted gross income (as defined in section 62 of the Code) increased by any amount excluded from gross income under sections 911, 931, or 933 of the Code.

(ii) *Decedents' estates and non-grantor trusts*. The term *modified adjusted gross income*, in the case of a decedent's estate or non-grantor trust, means adjusted gross income as defined in section 67(e) of the Code.

(9) *Negative equity*. The term *negative equity* means existing indebtedness on a vehicle traded in as part of a purchase transaction for an APV, to the extent such indebtedness exceeds the vehicle's trade-in value specified by the contract for the purchase of the APV.

(10) *Non-grantor trust*. The term *non-grantor trust* means a trust (or the portion of a trust) that is not a grantor trust.

(11) *Personal use*. The term *personal use* means use by an individual other than in any trade or business (except for the use in the trade or business of performing services as an employee), or for the production of income.

(12) *Purchase*. The term *purchase* means an acquisition that is both an acquisition of a vehicle for Federal income tax purposes and the acquisition of the title of the vehicle for purposes of State or other applicable law.

(13) *Qualified passenger vehicle loan interest (QPVLI)*. The term *qualified pas-*

senger vehicle loan interest or *QPVLI* means any interest that satisfies the requirements of paragraph (c)(1) of this section.

(14) *Qualified vehicle type*—(i) *In general*. The term *qualified vehicle type* means one of the following vehicle types:

(ii) *Car*. The term *car* means a vehicle classified in one of the classes of passenger automobiles listed in 40 CFR 600.315-08(a)(1).

(iii) *Minivan*. The term *minivan* means a minivan as defined under 40 CFR 600.002.

(iv) *Van*. The term *van* means a van as defined under 40 CFR 600.002.

(v) *Sport utility vehicle*. The term *sport utility vehicle* means a sport utility vehicle as defined under 40 CFR 600.002.

(vi) *Pickup truck*. The term *pickup truck* means a pickup truck as defined under 40 CFR 600.002.

(vii) *Motorcycle*. The term *motorcycle* means a motorcycle as defined under 49 CFR 571.3(b).

(15) *Secured by a first lien*. The term *secured by a first lien* means a valid and enforceable security interest under State or other applicable law in an APV that is the first voluntary security interest recorded against the vehicle, regardless of subsequent involuntary liens such as tax liens or other similar security interests that may be given temporary higher priority at a later date following the date of purchase. An APV may be considered to be secured by a first lien as long as there is a lending agreement evidencing a security interest under State or other applicable law, even if that lien has not yet been perfected or recorded due to processing times or other similar delays arising under State or other applicable law. An APV may also be treated as secured by a first lien in limited circumstances in which a lien is removed in connection with the taxpayer no longer owning the vehicle but the taxpayer continues to be liable for a specified passenger vehicle loan (SPVL), such as a repossession of the vehicle or insurance payout following a total loss claim.

(16) *Specified passenger vehicle loan (SPVL)*. The term *specified passenger vehicle loan* or *SPVL* means indebtedness that satisfies the requirements of paragraph (d)(1) of this section.

(17) *Vehicle identification number (VIN)*. The term *vehicle identification number* or *VIN* means a series of Arabic numbers and Roman letters that is assigned to a motor vehicle for identification purposes under 49 CFR 565.13.

(c) *Qualified passenger vehicle loan interest (QPVLI)*—(1) *In general*. Interest is QPVLI only if the interest is paid or accrued during the taxable year on indebtedness that is an SPVL secured by a first lien on an APV and is not excluded from the definition of QPVLI (as described in paragraphs (c)(4) and (5) of this section).

(2) *Determining the amount of interest paid or accrued during a taxable year*—(i) *In general*. Interest on an SPVL accrues on a daily basis over the term of the SPVL. The amount of QPVLI that is deductible by a taxpayer for the taxable year is determined under the taxpayer's overall method of accounting for Federal income tax purposes (either the cash receipts and disbursements method or an accrual method) or an applicable special method of accounting. For purposes of section 163(h)(4), the amount of QPVLI includes all interest payable with respect to the amount financed under an SPVL (that is, the amount of indebtedness that qualifies for purposes of determining whether indebtedness is an SPVL under paragraph (d)(2) of this section), including prepaid interest in the form of points and deferred or capitalized interest. QPVLI includes origination-related or financing-related charges, prepayment penalties, late payment charges, default-related charges, and similar fees, in each case if such charge, penalty, or fee is characterized as interest expense for Federal income tax purposes and included in the amount reported as interest received for the calendar year in the statement furnished by the interest recipient under section 6050AA(c) of the Code and § 1.6050AA-1(h).

(ii) *Allocation of payments*. In general, a payment on an SPVL is treated first as a payment of interest to the extent interest has accrued and remains unpaid on the SPVL as of the date the payment is due, and second, to the extent of any excess, as a payment of principal. See §§ 1.446-2(e) and 1.1275-2(a) for rules on allocating payments between interest and principal. However, for purposes of this paragraph (c)(2), the amount of interest for a calendar year is determined consistently with § 1.6050AA-1(f)(2) (special rule for interest accrued by January 15). For purposes of this paragraph (c)(2)(ii), a simple interest calculation may be used to determine the amount of interest that has accrued and remains unpaid on an SPVL when a payment on the SPVL is made. Under this simple interest calculation, interest accrues daily over the term of the SPVL based on its outstanding principal balance and the annual percentage rate or interest rate provided in the retail installment sales contract or other contract evidencing the SPVL.

(3) *Determining whether the SPVL is secured by a first lien on an APV*—(i) *In general*. In order for interest paid or accrued on an SPVL to be QPVLI, the SPVL must be secured by a first lien on the APV financed by the SPVL at the time the interest is paid or accrued. For example, the purchase of an APV with a credit card would generally not result in an SPVL secured by a first lien on an APV, because such indebtedness generally is not secured by the APV.

(ii) *Exception for a substitute vehicle due to an unforeseen intervening event*. In the case of an SPVL secured by a first lien on an APV that is replaced at a later time with a substitute vehicle that is an APV due to an unforeseen intervening event (for example, a defective APV is required to be replaced under State or other applicable law or an APV is required to be replaced under an insurance product), and as a result the SPVL is secured by a first lien on that substitute vehicle, the substitute vehicle is considered the initially purchased APV for purposes of this paragraph (c)(3), and for purposes of paragraphs (c)(5) and (d)(4) of this section.

(4) *Interest that is not QPVLI*. QPVLI does not include any amount paid or accrued on any of the following:

(i) A loan to finance fleet sales.

(ii) A loan incurred for the purchase of a commercial vehicle that is not used for personal purposes.

(iii) Any lease financing.

(iv) A loan to finance the purchase of a vehicle with a salvage title.

(v) A loan to finance the purchase of a vehicle intended to be used for scrap or parts.

(5) *VIN requirement*. Interest paid or accrued by the taxpayer during the taxable year on an SPVL is not treated as QPVLI and may not be deducted as QPVLI under section 163(a) unless the taxpayer reports the VIN of the purchased APV on the Federal tax return for the taxable year in the manner prescribed by the Internal Revenue Service in guidance published in the Internal Revenue Bulletin or in forms and instructions.

(6) *Examples*. The rules of paragraphs (c)(1), (c)(3), and (c)(4)(iii) of this section are illustrated by the following examples:

(i) *Example 1: Lease financing*—(A) *Facts*. Dealer is located in State Y. Dealer purchases an APV from the manufacturer and sells the car to Leasing Company. Leasing Company leases the car to A for a 120-month period in a transaction that is a lease for State Y purposes. At the end of the lease term, A has the option to purchase the car for a nominal amount. For Federal income tax purposes, the lease agreement is properly viewed as a sale. A makes lease payments during the taxable year.

(B) *Analysis*. A's lease payments are made under a lease financing transaction and do not qualify as QPVLI. Additionally, notwithstanding that the lease agreement is properly viewed as a sale for Federal income tax purposes, the transaction is not a purchase as defined in paragraph (b)(12) of this section and therefore the lease is not an SPVL. Accordingly, no amounts paid under the lease are QPVLI.

(ii) *Example 2: Defective vehicle replaced*—(A) *Facts*. A, a resident of State X, incurs an SPVL to purchase Vehicle 1. The SPVL is secured by a first lien on Vehicle 1. After purchase, A discovers Vehicle 1 is defective. Under State X law that requires the replacement of new vehicles with serious defects, the manufacturer replaces defective Vehicle 1 with Vehicle 2. As a result, the SPVL is secured by a first lien on Vehicle 2. Vehicle 2 is an APV with respect to A, as the original use of Vehicle 2 commences with A, and the vehicle meets all other requirements of an APV as described in paragraph (e) of this section. The SPVL continues to be in effect with no changes other than the substitution of Vehicle 1 for Vehicle 2 occurring under State X law. A continues making payments under the terms of the SPVL.

(B) *Analysis*. The interest paid or accrued on the SPVL that is now secured by Vehicle 2 is QPVLI. The SPVL is secured by a first lien on the APV that was purchased as a result of the incurred SPVL at the time that interest is paid or accrued. As Vehicle 1 was replaced with Vehicle 2, an APV, due to an unforeseen intervening event and the SPVL is secured by a first lien on Vehicle 2, Vehicle 2 is considered the initially purchased APV.

(d) *Specified passenger vehicle loan (SPVL)*—(1) *In general*. Indebtedness is an SPVL only if the indebtedness is incurred by the taxpayer after December 31, 2024, for the purchase of an APV for personal use, and is secured by a first lien on that APV.

(2) *Indebtedness incurred for the purchase of an APV*—(i) *In general*. For purposes of paragraph (d)(1) of this section, indebtedness is an SPVL only to the extent the indebtedness is incurred for the purchase of an APV and, if part of the same purchase transaction, for any other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV. Items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV include, but are not limited to, vehicle service or repair plans (for example, mechanical repair coverage), vehicle protection products (including tire, wheel, paint, and interior protection products), key fob replacement plans, warranties or extended warranties, guaranteed asset protection (GAP) waiver or insurance that covers the difference between an APV's value and the outstanding balance of the indebtedness in the event of a total loss, credit insurance products (including credit-related accident, health, and life products), sales taxes, vehicle-related fees (including title and registration fees), and vehicle-related accessories that are components of the APV purchased as part of the APV transaction.

(ii) *Indebtedness that is not incurred for the purchase of an APV*. To the extent any indebtedness is not incurred by a taxpayer for the purchase of an APV or for any other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV, such indebtedness is not an SPVL even if it is incurred as part of a purchase transaction for an APV. For example, indebtedness incurred for the repayment of negative equity on a loan secured by a trade-in vehicle, to purchase collision and liability insurance that is not a credit insurance product, or to purchase any property or services unrelated to an APV (for example, a trailer or a boat) is not incurred by a taxpayer for the purchase of an APV or for any other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV, and as a result is not an SPVL. In addition, indebtedness is not incurred by a taxpayer for the purchase of an APV or for any other items or amounts customarily financed that are directly related to the purchase of the APV in an APV purchase transaction to the extent the indebtedness relates to cash proceeds that the taxpayer receives from the lender.

(iii) *Allocation of indebtedness*—(A) *In general*. Except as provided in paragraph (d)(2)(iii)(B) of this section, if a taxpayer incurs indebtedness described in both paragraphs (d)(2)(i) and (ii) of this section as part of the same transaction, the indebtedness must be allocated between the indebtedness described in paragraph (d)(2)(i) of this section and the indebtedness described in paragraph (d)(2)(ii) of this section. Only the portion of the indebtedness allocated to the indebtedness described in paragraph (d)(2)(i) of this section is an SPVL. In such cases, payments of interest and principal are allocated to the portion of the indebtedness described in paragraph (d)(2)(i) of this section and the portion of the indebtedness described in paragraph (d)(2)(ii) of this section on a pro rata basis.

(B) *Allocation of a down payment*. For purposes of determining the portion of the indebtedness described in paragraph (d)(2)(ii) of this section, any down payment (or other consideration provided by the taxpayer at the time of the APV purchase transaction) is applied first against any negative equity and any other amounts that are not incurred for the purchase of the APV or for other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV.

(3) *Related party indebtedness*. Any indebtedness owed to a person who is related to the taxpayer within the meaning of section 267(b) or section 707(b)(1) of the Code is not an SPVL.

(4) *Refinancing of an SPVL*. If a taxpayer refinances an SPVL (refinanced loan), the resulting indebtedness (new loan) is an SPVL if the new loan is secured by a first lien on the APV with respect to which the refinanced loan was incurred. The amount of the new loan that is an SPVL is limited to the outstanding balance of the refinanced loan as of the date of the refinancing. A taxpayer allocates principal and interest between the amount of the new loan that is an SPVL and the remaining portion of the indebtedness on a pro rata basis. For purposes of this paragraph (d)(4), if there is a change in obligor as

part of the refinancing, the new loan is not an SPVL with regard to any subsequent obligor unless the refinancing is in connection with a change in obligor by reason of the obligor's death within the meaning of paragraph (d)(5)(ii) of this section.

(5) *Whether the SPVL was incurred by the taxpayer*—(i) *In general*. Except as provided in paragraph (d)(5)(ii) of this section, indebtedness is an SPVL only if that indebtedness was originally incurred by the taxpayer. For example, if an individual incurs an SPVL and subsequently ceases to be an obligor and another individual becomes the obligor on the indebtedness, the indebtedness is not an SPVL with respect to the other individual.

(ii) *Exception for a change in obligor by reason of the death of an obligor*—(A) *In general*. If a change in obligor is by reason of the death of an obligor of an SPVL, then the indebtedness is treated as an SPVL with respect to the new obligor.

(B) *Change in obligor by reason of the death of an obligor.* For purposes of paragraph (d)(5)(ii)(A) of this section, a change in obligor by reason of death includes the following:

(*1*) The succession to ownership of an APV subject to an SPVL by—

(*i*) The deceased obligor's estate;

(*ii*) A surviving joint owner of the APV; or

(*iii*) The surviving beneficiary designated by contract, a transfer on death provision, or by operation of law.

(*2*) A distribution of an APV subject to an SPVL by—

(*i*) A deceased obligor's estate to a legatee or heir; or

(*ii*) A trust that is made to a trust beneficiary by reason of death as described in this paragraph (d)(5)(ii).

(*3*) Any refinancing of an SPVL in connection with a transfer by reason of death as described in this paragraph (d)(5)(ii).

(C) *Not a change in obligor by reason of the death of an obligor.* A change in obligor by reason of death as described in this paragraph (d)(5)(ii) does not include a change resulting from the following:

(*1*) A sale, exchange, or other disposition of an APV by a decedent's estate or trust, other than a distribution described in paragraph (d)(5)(ii)(B)(*2*) of this section.

(*2*) Any disposition of an APV by an individual who received the APV by reason of death (unless that disposition is by reason of that individual's death and the change in obligor is described in paragraph (d)(5)(ii)(B) of this section).

(6) *Examples*. The rules of paragraphs (d)(2) and (4) of this section are illustrated by the following examples in which A is an individual who incurs indebtedness after December 31, 2024, to purchase an APV for personal use:

(i) *Example 1: Vehicle-related purchases*—(A) *Facts*. A finances the purchase of an APV for personal use by incurring a loan. The loan is secured by a first lien on the APV. The retail installment sales contract, which evidences the loan, indicates that the total amount financed is equal to the sum of the APV purchase price, the cost for an extended warranty, sales tax, title and registration fees, and a dealer document fee.

(B) *Analysis*. All of the amount financed under the loan is incurred for the purchase of an APV and for other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV. Accordingly, the loan is an SPVL and all of the interest on the loan may be deductible as QPVLI.

(ii) *Example 2: Non-vehicle-related purchase*—(A) *Facts*. A incurs indebtedness to finance the purchase of both an APV and a trailer. The indebtedness is secured by a first lien on the APV. The price of the trailer is added to the amount financed as part of the retail installment sales contract that includes the purchase price of the APV. A does not make a down payment.

(B) *Analysis*. The indebtedness attributable to the purchase price of the trailer included in the amount financed under the retail installment sales contract is not incurred for the purchase of an APV or for any other items or amounts customarily financed in an APV purchase transaction that are directly related to the purchase of the APV and therefore this indebtedness is not an SPVL under paragraph (d)(2)(ii) of this section. In accordance with the allocation rules in paragraph (d)(2)(iii) of this section, A must allocate the portion of the indebtedness that is allocable to the purchase price of the trailer to indebtedness described in paragraph (d)(2)(ii) of this section that is not an SPVL. Thus, none of the interest that is attributable to that portion of the indebtedness is QPVLI. The remaining portion of the indebtedness is allocated to indebtedness described in paragraph (d)(2)(i) of this section that is an SPVL.

(iii) *Example 3: Vehicle refinanced*—(A) *Facts*. A incurs indebtedness (Loan 1) to finance the purchase of an APV, and in a subsequent taxable year in which A is eligible to deduct QPVLI, A refinances Loan 1 by incurring new indebtedness of $38,000 (Loan 2), which is secured by a first lien on the APV. At the time of refinancing, the APV has a fair market value of $38,000 and Loan 1 has an outstanding balance of $30,000. The Loan 2 proceeds of $38,000 are used to first repay the $30,000 Loan 1 balance, with the remaining $8,000 going to A as cash proceeds.

(B) *Analysis*. Of the $38,000 amount financed by Loan 2, $8,000 is the amount of the resulting indebtedness that exceeds the amount of such refinanced indebtedness within the meaning of paragraph (d)(4) of this section. Only $30,000 of the $38,000 balance of Loan 2 is an SPVL per the rule in paragraph (d)(4) of this section. Thus, none of the interest attributable to the $8,000 portion of Loan 2 is interest that is deductible as QPVLI.

(iv) *Example 4: Negative equity and a down payment*—(A) *Facts*. A finances the purchase of an APV that costs $40,000, and trades in a previously owned vehicle subject to an existing vehicle loan with $6,000 of negative equity. A makes a down payment of $4,000 as part of the APV purchase transaction, incurring indebtedness of $42,000 ($40,000 plus $6,000 minus $4,000).

(B) *Analysis*. The $6,000 of negative equity is not an item or amount customarily financed in an APV purchase transaction that directly relates to the purchase of the APV. See paragraph (d)(2)(ii) of this section. In accordance with the allocation rules in paragraph (d)(2)(iii) of this section, A must allocate the $42,000 of indebtedness between indebtedness described in paragraph (d)(2)(i) of this section and indebtedness described in paragraph (d)(2)(ii) of this section. For purposes of determining the portion of the indebtedness described in paragraph (d)(2)(ii) of this section, the down payment of $4,000 is allocated against the $6,000 of negative equity. As a result, of the $42,000 of indebtedness incurred by A, $40,000 of the indebtedness incurred is indebtedness incurred for the purchase of an APV as described in paragraph (d)(2)(i) of this section and $2,000 is indebtedness not incurred for the purchase of an APV as described in paragraph (d)(2)(ii) of this section.

(v) *Example 5: Method of allocating interest*—(A) *Facts*. A finances the purchase of an APV for personal use by incurring a loan of $40,000, of which $36,000 was for amounts described in paragraph (d)(2)(i) of this section and of which $4,000 was for amounts described in paragraph (d)(2)(ii) of this section. A did not make a down payment.

(B) *Analysis*. Under paragraph (d)(2)(iii) of this section, the loan must be allocated between indebtedness that is an SPVL and indebtedness that is not an SPVL. The percentage of the loan that is described in paragraph (d)(2)(i) of this section and is an SPVL is 90 percent ($36,000/$40,000) and the percentage of the loan that is described in paragraph (d)(2)(ii) of this section and is not an SPVL is 10 percent ($4,000/$40,000). As a result, only 90 percent of each interest payment on the loan may be QPVLI. The remaining 10 percent of each interest payment on the loan is not QPVLI.

(e) *Applicable passenger vehicle (APV)*—(1) *In general*. A vehicle is an APV only if—

(i) The original use of the vehicle commences with the taxpayer (as described in paragraph (e)(2) of this section);

(ii) The vehicle is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails);

(iii) The vehicle has at least 2 wheels;

(iv) The vehicle is a qualified vehicle type;

(v) The vehicle is treated as a motor vehicle for purposes of title II of the Clean Air Act;

(vi) The vehicle has a gross vehicle weight rating of less than 14,000 pounds; and

(vii) The final assembly of the vehicle occurs within the United States (as described in paragraph (e)(3) of this section).

(2) *Determining whether original use commences with the taxpayer*—(i) *In general*. Original use of a vehicle commences with the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled (taking into account paragraphs (e)(2)(ii) and (iii) of this section). In the case of a purchaser that incurs indebtedness for the vehicle purchase, original use of the vehicle does not commence with that purchaser unless the loan documentation treats the vehicle as a new vehicle.

(ii) *Dealers*. Original use of a vehicle held by a dealer does not commence with the dealer if the vehicle is held primarily for sale to customers in the ordinary course of its trade or business, and as a result the dealer is not considered to be the first person that takes delivery of the vehicle after it is sold, registered, or titled as described in paragraph (e)(2)(i) of this section. However, original use of a vehicle may commence with a dealer if the vehicle is held by the dealer for any purpose other than primarily for sale to customers in the ordinary course of its trade or business.

(iii) *Original use for joint purchasers*. If more than one person purchases a vehicle and one of these purchasers is the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled, then each of these purchasers is considered to be the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled as described in paragraph (e)(2)(i) of this section.

(iv) *Vehicle return exception*. If a purchaser that is not a dealer returns a vehicle to a seller within 30 days of taking delivery of the vehicle, then that purchaser will not be considered the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled for purposes of paragraph (e)(2)(i) of this section, and, accordingly, original use of the vehicle does not commence with that purchaser.

(v) *Examples*. The rules of this paragraph (e) are illustrated by the following examples:

(A) *Example 1: Demonstrator vehicles*—(*1*) *Facts*. Dealer purchases and takes delivery of a vehicle from the manufacturer. Dealer has always held the vehicle primarily for sale to customers in the ordinary course of Dealer's trade or business and also uses the vehicle as a demonstrator vehicle. Dealer titles and registers the vehicle in its name prior to use as a demonstrator vehicle in accordance with State law requirements.

(*2*) *Analysis*. Original use of the vehicle does not commence with Dealer. Although Dealer titled and registered the vehicle as required by State law, the vehicle was always held by Dealer primarily for sale to customers in the ordinary course of Dealer's trade or business. Accordingly, Dealer is not considered to be the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled. Original use of the vehicle may commence with a subsequent purchaser of the vehicle.

(B) *Example 2: Cancelled sale*—(*1*) *Facts*. A enters into a contract to purchase a special-order vehicle from Dealer that is estimated to be delivered in one month. When Dealer purchases the vehicle from the manufacturer, Dealer holds the vehicle primarily for sale to customers in the ordinary course of Dealer's trade or business. A cancels the order under the sales contract prior to the delivery occurring.

(*2*) *Analysis*. Original use of the vehicle does not commence with Dealer. The vehicle was always held by Dealer primarily for sale to customers in the ordinary course of Dealer's trade or business. Thus, Dealer is not considered to be the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled. Original use of the vehicle does not commence with A because A cancelled the order. A is not the first person that takes delivery of the vehicle after it is sold, registered, or titled. Original use of the vehicle may commence with a subsequent purchaser of the vehicle.

(C) *Example 3: Vehicle purchase following a lease*—(*1*) *Facts*. Dealer is engaged in the business of purchasing vehicles to sell to vehicle leasing companies. Dealer only holds these vehicles primarily for sale to customers in the ordinary course of Dealer's trade or business. Dealer sells a vehicle purchased from the manufacturer to Leasing Company. Leasing Company is not a dealer. Leasing Company takes delivery of the vehicle after titling and registering the vehicle in its name. Leasing Company immediately leases the vehicle to A. At the end of the lease term, A exercises its option under the lease agreement to purchase the vehicle.

(*2*) *Analysis*. Original use of the vehicle does not commence with Dealer. The vehicle was always held by Dealer primarily for sale to customers in the ordinary course of Dealer's trade or business. Thus, Dealer is not considered to be the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled. Original use of the vehicle commences with Leasing Company. Leasing Company is the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled. Accordingly, the original use of the vehicle does not commence with A as A is not the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled.

(D) *Example 4: Returned vehicle*—(*1*) *Facts*. A, who is not a dealer, purchases a vehicle from Dealer. Dealer purchased the vehicle from the manufacturer and has always held the vehicle primarily for sale to customers in the ordinary course of Dealer's trade or business. A returns the car to Dealer 15 days after taking delivery of the vehicle.

(*2*) *Analysis*. Original use of the vehicle does not commence with Dealer. The vehicle was always held by Dealer for sale to customers in the ordinary course of Dealer's trade or business. Thus, Dealer is not considered to be the first person that takes delivery of the vehicle after the vehicle is sold, registered, or titled. Original use of the vehicle does not commence with A. A is not considered to be the first person that takes delivery of the vehicle after it is sold, registered, or titled as A returned the vehicle to Dealer within 30 days of taking delivery of the vehicle. Original use of the vehicle may commence with a subsequent purchaser of the vehicle.

(3) *Determining whether final assembly has occurred within the United States*. To determine whether the final assembly of a vehicle occurred within the United States, a taxpayer may rely on—

(i) The vehicle's plant of manufacture as reported in the VIN; or

(ii) The final assembly point reported on the label affixed to the vehicle as described in 49 CFR 583.5(a)(3).

(f) *Determination of personal use*—(1) *In general*. A taxpayer that incurs indebtedness to purchase an APV is considered to purchase that APV for personal use if, at the time the indebtedness is incurred, that taxpayer expects that the APV will be used for personal use by the taxpayer, the taxpayer's spouse, or an individual that is related to the taxpayer within the meaning of section 152(c)(2) or (d)(2) of the Code, or any combination of these individuals, for more than 50 percent of the time. The determination of whether the taxpayer purchased the APV for personal use is based on the expected use during the period the taxpayer expects to own the APV.

(2) *Special rules for decedents' estates and non-grantor trusts*. For purposes of determining whether a decedent's estate or non-grantor trust that incurs indebtedness to purchase an APV expects that the APV will be used for personal use under paragraph (f)(1) of this section, the determination is based on the expected personal use by one or more of the legatees or heirs, or beneficiaries, respectively, who have a

present or future interest in that decedent's estate or non-grantor trust; the spouse of a legatee, heir, or beneficiary; or an individual that is related to a legatee, heir, or beneficiary within the meaning of section 152(c)(2) or (d)(2).

(3) *Examples*. The rules of this paragraph (f) are illustrated by the following examples in which A is an individual:

(i) *Example 1: Predominant personal use*—(A) *Facts*. At the time A incurs indebtedness to purchase an APV, A expects to use the APV for A's personal use for 85 percent of the time. A expects to use the APV to earn income as a driver for a rideshare service for the remaining 15 percent of the time.

(B) *Analysis*. A is considered to have purchased the APV for personal use. At the time A purchases the APV, A expects that the APV will be used for personal use more than 50 percent of the time. A's expectation that A will use the APV to earn income as a driver for a rideshare service for 15 percent of the time does not preclude A from being considered to have purchased the APV for personal use.

(ii) *Example 2: Predominant business use*—(A) *Facts*. At the time A incurs indebtedness to purchase an APV, A expects to use the APV in A's contracting business that is a sole proprietorship for 60 percent of the time. A expects to use the APV for A's personal use for the remaining 40 percent of the time.

(B) *Analysis*. A is not considered to have purchased the APV for personal use. At the time A purchases the APV, A does not expect that the APV will be used for personal use more than 50 percent of the time.

(iii) *Example 3: Personal use by an individual related to the taxpayer*—(A) *Facts*. At the time A incurs indebtedness to purchase an APV, A expects the APV to be used exclusively for personal use by A's child B.

(B) *Analysis*. A is considered to have purchased the APV for personal use. At the time A purchases the APV, A expects that the APV will be used for personal use more than 50 percent of the time by B, an individual that is related to A within the meaning of section 152(c)(2) or (d)(2).

(g) *Independently deductible interest*—(1) *In general*. Independently deductible interest is limited to interest that is QPVLI determined under section 163(h)(4)(B)(i) (prior to the application of the dollar limitation of section 163(h)(4)(C)(i) described in paragraph (h)(1) of this section and determined without regard to this paragraph (g)) and that is otherwise deductible by the taxpayer as a different type of interest under section 163(a) or a different section of the Code.

(2) *Deducting independently deductible interest*. A taxpayer may deduct independently deductible interest paid or accrued by the taxpayer during the taxable year as QPVLI (subject to the application of the dollar limitation of section 163(h)(4)(C)(i) described in paragraph (h)(1) of this section), or alternatively, as a different type of interest described in paragraph (g)(1) of this section (non-QPVLI), subject to any applicable limitations. The amount of independently deductible interest that may be deductible as QPVLI for a taxable year (before the application of the dollar limitation of section 163(h)(4)(C)(i) described in paragraph (h)(1) of this section) is reduced to the extent that the taxpayer deducts that independently deductible interest as non-QPVLI.

(3) *Reporting independently deductible interest*. If a taxpayer deducts independently deductible interest in a taxable year as non-QPVLI under paragraph (g)(2) of this section, the taxpayer must report information relating to that independently deductible interest in the manner prescribed by the Internal Revenue Service in guidance published in the Internal Revenue Bulletin or in forms and instructions.

(4) *Examples*. The rules of this paragraph (g) regarding independently deductible interest are illustrated by the following examples in which A is an individual:

(i) *Example 1: Independently deductible interest*—(A) *Facts*. During the taxable year, A paid $1,000 of interest on an SPVL. During the taxable year, 40 percent of the use of the APV is attributable to A's trade or business. A may deduct the full $1,000 as QPVLI after considering the application of the modified adjusted gross income phaseout in paragraph (h)(2) of this section as A's modified adjusted gross income is less than $100,000.

(B) *Analysis*. $400 (40% of $1,000) is independently deductible interest because this amount is deductible as QPVLI and as business interest under section 163(a). Assume A may deduct the full $400 as business interest after considering any applicable limitations. A may deduct the interest paid on the SPVL in multiple ways including—

(*1*) A may deduct this $400 of interest as QPVLI. In this case, A would deduct all $1,000 of interest as QPVLI; or

(*2*) A may deduct this $400 as business interest. In this case, A would deduct $600 as QPVLI and $400 as business interest, because A must reduce its $1,000 of QPVLI by the $400 of interest deducted as business interest to determine the amount A can deduct as QPVLI. Additionally, A must report information relating to that independently deductible interest in the manner prescribed by the Internal Revenue Service in guidance published in the Internal Revenue Bulletin or in forms and instructions.

(ii) *Example 2: QPVLI limited by the dollar limitation*—(A) *Facts*. During the taxable year, A paid $12,000 of interest on an SPVL. During the taxable year, 30 percent of the use of the APV is attributable to A's trade or business. A may deduct up to $10,000 of the interest as QPVLI after considering the application of the dollar limitation and the modified adjusted gross income phaseout in paragraphs (h)(1) and (2) of this section as A's modified adjusted gross income is less than $100,000.

(B) *Analysis*. $3,600 (30% of $12,000) is independently deductible interest because this amount is deductible as QPVLI and as business interest under section 163(a). Assume A may deduct the full $3,600 as business interest after considering any applicable limitations. A may deduct the interest paid on the SPVL in multiple ways including—

(*1*) A may maximize QPVLI deducted. A may deduct $10,000 of interest as QPVLI, and deduct the remaining $2,000 as business interest. Additionally, A must report information relating to that independently deductible interest in the manner prescribed by the Internal Revenue Service in guidance published in the Internal Revenue Bulletin or in forms and instructions; or

(*2*) A may maximize business interest deducted. A may deduct $3,600 of business interest, and the remaining $8,400 as QPVLI. A has $12,000 of interest paid on an SPVL and must reduce that by the amount of independently deductible interest A deducts as business interest ($3,600). Additionally, A must report information relating to that independently deductible interest in the manner prescribed by the Internal Revenue Service in guidance published in the Internal Revenue Bulletin or in forms and instructions.

(iii) *Example 3: QPVLI limited by the dollar limitation*—(A) *Facts*. During the taxable year, A paid $15,000 of interest on an SPVL. During the taxable year, 20 percent of the use of the APV is attributable to A's trade or business. A may deduct up to $10,000 of the interest as QPVLI after considering the application of the dollar limitation and the modified adjusted gross income phaseout in paragraphs (h)(1) and (2) of this section as A's modified adjusted gross income is less than $100,000.

(B) *Analysis*. $3,000 (20% of $15,000) is independently deductible interest because this amount is deductible as QPVLI and as business interest under section 163(a). Assume A may deduct the full $3,000 as business interest after considering any applicable limitations. Therefore, the $3,000 is deductible as business interest or as QPVLI. If A were to deduct the $3,000 of independently deductible interest as QPVLI, the application of the dollar limitation in paragraph (h)(1) of this section would limit A's deduction of QPVLI to $10,000 of the $15,000. Instead, A may deduct $3,000 of interest as business interest and deduct $10,000 as QPVLI as the modified adjusted gross income phaseout in paragraph (h)(2) of this section does not reduce A's QPVLI deduction amount. Additionally, A must report information relating to that independently deductible interest in the manner prescribed by the Internal Revenue Service in guidance published in the Internal Revenue Bulletin or in forms and instructions.

(h) *Limitations*—(1) *Dollar limitation*. The amount taken into account as QPVLI by a taxpayer for any taxable year may not exceed $10,000 per Federal tax return regardless of filing status.

(2) *Modified adjusted gross income phaseout*. The amount taken into account as QPVLI (after the application of the dollar limitation in paragraph (h)(1) of this section) is reduced (but not below zero) by $200 for each $1,000 (or portion thereof) by which the modified adjusted gross income of the taxpayer for the taxable year exceeds $100,000 or, in the case of a joint Federal income tax return, by which the modified adjusted gross income exceeds $200,000.

(3) *Examples*. The rules of this paragraph (h) are illustrated by the following examples:

(i) *Example 1: Dollar limitation*—(A) *Facts*. A and B are married and file a joint Federal income tax return. A incurs an SPVL to purchase Vehicle 1. B incurs an SPVL to purchase Vehicle 2. During the taxable year, A paid $6,000 of interest on the SPVL for Vehicle 1. B paid $5,000 of interest on the SPVL for Vehicle 2.

(B) *Analysis*. A and B can deduct no more than $10,000 as QPVLI on their joint Federal income tax return because of the dollar limitation described in paragraph (h)(1) of this section.

(ii) *Example 2: Modified adjusted gross income phaseout*—(A) *Facts*. A is an individual that paid $7,000 of QPVLI on an SPVL during the taxable year and files a Federal income tax return with a filing status as single. A has a modified adjusted gross income of $124,200 for the taxable year.

(B) *Analysis*. The maximum amount of QPVLI that A can deduct for the taxable year is $2,000. A's modified adjusted gross income is greater than $100,000. Therefore, the amount of QPVLI that can be taken into account as QPVLI after the application of the dollar limitation ($7,000) must be reduced by $200 for each $1,000 (or portion thereof) that A's modified adjusted gross income exceeds $100,000. A's modified adjusted gross income exceeds $100,000 by $24,200. Thus, the $7,000 amount must be reduced by $5,000, which is equal to $200 x 25 ($24,200 / $1,000 = 24.2 (which is then rounded up to 25)).

(i) *Applicability date*. This section applies to taxable years beginning after December 31, 2024, and before January 1, 2029.

Par. 3. Section 1.6050AA-1 is added to read as follows:

§ 1.6050AA-1 Information reporting of applicable passenger vehicle loan interest received in a trade or business from an individual.

(a) *Information reporting requirement*—(1) *Overview*. The information reporting requirements of section 6050AA of the Internal Revenue Code (Code) and this section apply to an interest recipient who receives at least $600 of interest on a specified passenger vehicle loan (SPVL) from a payor of record for a calendar year for which interest is received. See paragraph (b) of this section for definitions of terms used in section 6050AA and this section.

(2) *Reporting requirement*. Except as otherwise provided in this section, an interest recipient that receives at least $600 of interest on an SPVL for a calendar year must—

(i) File an information return, as described in paragraph (g) of this section, with the Internal Revenue Service (IRS); and

(ii) Furnish a statement to the payor of record, as described in paragraph (h) of this section, on the SPVL.

(3) *Optional reporting*. An interest recipient may, but is not required to, report its receipt of less than $600 of interest on an SPVL for a calendar year. An interest recipient that chooses to file a return as provided in this section and to furnish a statement as provided in this section is subject to the requirements of this section.

(b) *Definitions*. The following definitions apply for purposes of section 6050AA and this section:

(1) *Applicable passenger vehicle (APV)*. The term *applicable passenger vehicle* or *APV* has the meaning provided in § 1.163-16(b)(1).

(2) *Calendar year for which interest is received*. Except as provided in paragraph (f)(2) of this section, the *calendar year for which interest is received* is the later of the calendar year in which the interest is received or the calendar year in which the interest properly accrues.

(3) *Interest recipient*. An *interest recipient* is a person that is engaged in a trade or business (whether or not the trade or business of lending money) and that, in the course of that trade or business, receives from any payor of record interest on an SPVL. For purposes of this paragraph (b)(3), if a person holds an SPVL that was originated or acquired in the course of a trade or business, the interest on the SPVL is considered to be received in the course of that trade or business. The rules of this paragraph (b)(3) are illustrated by the following examples:

(i) *Example 1: Financing entity*—(A) *Facts*. Car manufacturer finance subsidiary A lends money to individual B to enable B to purchase an APV. B makes a payment to A of interest on the SPVL.

(B) *Analysis*. Under the rules of this paragraph (b)(3), A is an interest recipient for purposes of section 6050AA and is subject to the reporting requirements of section 6050AA.

(ii) *Example 2: Interest not in the course of the trade or business*—(A) *Facts*. C, a person engaged in the trade or business of being a physician, lends money to individual D to enable D to purchase an APV from car dealer A. D makes a payment to C of interest on the SPVL.

(B) *Analysis*. C is not an interest recipient for purposes of section 6050AA and this paragraph (b)(3) because C will not receive the interest in the course of the trade or business of being a physician. C does not need to file an information return reporting the interest received from D.

(iii) *Example 3: Dealer direct lending*—(A) *Facts*. E, a corporation, is a car dealer operating under the "buy here, pay here" model. E sells vehicles to customers and, as part of its ordinary course of business, extends financing directly to the purchasers. Customer F buys a vehicle from E and enters into an SPVL with E for the amount necessary to buy the vehicle. F pays E $1,200 of stated interest on the SPVL during the calendar year.

(B) *Analysis*. Because E is engaged in the trade or business of selling automobiles and receives interest on the SPVL in the course of that trade or business, E is an interest recipient for purposes of section 6050AA and must file an information return reporting the interest received from F.

(4) *Lender of record*. The *lender of record* is the person who, at the time the loan is originated, is named as the lender on the loan documents and whose right to receive payment from the payor of record is secured by a lien on the payor of record's APV. An intention by the lender of record to sell or otherwise transfer the loan to a third party subsequent to the close of the transaction does not affect the determination of who is the lender of record.

(5) *Payor of record*. The *payor of record* on an SPVL is the person specified on the books and records of the interest recipient as the principal borrower on the SPVL. If the books and records of the interest recipient do not indicate which borrower is the principal borrower, the interest recipient must designate a borrower as the principal borrower. The term *person* for purposes of this paragraph (b)(5) means any individual, decedent's estate, or trust that is not a grantor trust within the meaning of § 1.163-16(b)(10) (non-grantor trust).

(6) *Secretary*. The term *Secretary* has the meaning provided in section 7701(a)(11) of the Code.

(7) *Specified passenger vehicle loan (SPVL)*. The term *specified passenger vehicle loan* or *SPVL* has the same meaning given by § 1.163-16(b)(16).

(c) *Interest received on behalf of another person*—(1) *In general*. A person that, in the course of its trade or business, receives or collects interest on an SPVL on behalf of another person (for example, the lender of record) is the interest recipient (initial recipient) for purposes of paragraph (b)(3) of this section with respect to the SPVL. In this case, the reporting requirement of paragraph (a) of this section does not apply to the transfer of interest from the initial recipient to the person for which the initial recipient receives or collects the interest. For example, if financial institution A collects interest on behalf of financial institution B, A is the initial recipient of interest for the SPVL and is subject to the reporting requirements of section 6050AA. B is not required to report the interest received on the SPVL from A.

(2) *Exception*. Paragraph (c)(1) of this section does not apply for any period for which—

(i) An initial recipient does not possess the information needed to comply with the reporting requirement of paragraph (a) of this section; and

(ii) The person for which the interest is received or collected would receive the interest in the course of its trade or business if the interest were paid directly to that person.

(3) *Application of the exception*. If the exception provided by paragraph (c)(2) of this section applies, the person for which the interest is received or collected is the interest recipient with respect to interest received or collected on the SPVL.

(4) *Presumption.* For purposes of this paragraph (c), if interest is received or collected on behalf of a person other than an individual, that person is presumed to receive interest in the course of its trade or business.

(5) *Examples*. The rules of this paragraph (c) are illustrated by the following examples:

(i) *Example 1: Servicer has the information needed to comply with the reporting requirement*—(A) *Facts*. Bank A lends money to individual B to purchase an APV. Bank A forms a securitization trust and sells securities that are backed by SPVLs. Securitization Servicer C is the loan servicer and collects interest on the SPVLs in the trust on behalf of Bank A. Securitization Servicer C has the initial information regarding loans in the trust (for example, loan amount details and VINs corresponding to the SPVLs), as well as information regarding the amounts of interest paid on the SPVLs, such that Securitization Servicer C has the information needed to comply with the reporting requirement of paragraph (a) of this section.

(B) *Analysis*. Securitization Servicer C is the initial recipient of interest for the SPVL and is subject to the reporting requirements of section 6050AA. Bank A is not required to report the interest received on the SPVL from Securitization Servicer C.

(ii) *Example 2: Servicer does not have the information needed to comply with the reporting requirement*—(A) *Facts*. Bank D lends money to individual E to purchase an APV. Bank D forms a securitization trust and sells securities that are backed by SPVLs. Payment Agent F collects interest on the SPVLs in the trust on behalf of Bank D, but Bank D otherwise acts as the loan servicer. Payment Agent F does not have the information needed to comply with the reporting requirement of paragraph (a) of this section.

(B) *Analysis*. Payment Agent F collects interest on behalf of Bank D. However, because Payment Agent F does not have the information needed to comply with the reporting requirement of paragraph (a) of this section, Payment Agent F is not the initial recipient of interest for the SPVL. Bank D is subject to the reporting requirements of section 6050AA.

(d) *Reporting by a foreign person*. An interest recipient that is not a United States person, as defined in section 7701(a)(30), must report interest received on an SPVL only if it receives the interest—

(1) At a location in the United States; or

(2) At a location outside the United States and—

(i) The interest recipient is a controlled foreign corporation, within the meaning of section 957(a) of the Code; or

(ii) 50 percent or more of the gross income of the interest recipient from all sources for the three-year period ending with the close of the taxable year preceding the receipt of interest (or for that part of the period for which the person was in existence) was effectively connected with the conduct of a trade or business in the United States.

(e) *Reporting with respect to a nonresident alien individual, foreign decedent's estate, or foreign non-grantor trust*—(1) *In general*. The reporting requirement of paragraph (a) of this section does not apply if the payor of record is a nonresident alien individual, a decedent's estate that is a foreign estate within the meaning of section 7701(a)(31)(A), or a non-grantor trust that is a foreign trust within the meaning of section 7701(a)(31)(B).

(2) *Nonresident alien individual, foreign decedent's estate, and foreign non-grantor trust*. For purposes of paragraph (e)(1) of this section, an interest recipient must apply the following documentation rules to determine whether a payor of record is a nonresident alien individual, foreign decedent's estate, or foreign non-grantor trust—

(i) If interest is paid outside the United States, the interest recipient must satisfy the documentary evidence standard provided in § 1.6049-5(c) with respect to the payor of record; and

(ii) If interest is paid within the United States, the interest recipient must secure from the payor of record an applicable Form W-8 (or a substitute form) that meets the validity and reliance requirements described in § 1.1441-1(e)(4).

(3) *Place of payment*. For purposes of paragraph (e)(2) of this section, the place of payment is the place where the payor of record completes the acts necessary to effect payment. An amount paid by transfer to an account maintained by an interest recipient in the United States or by mail to a United States address is considered to be paid within the United States.

(f) *Amount of interest received on an SPVL for calendar year*—(1) *De minimis rule for interest of less than $600.* Whether an interest recipient receives $600 or more of interest on an SPVL for a calendar year is determined on an SPVL-by-SPVL basis. An interest recipient need not aggregate the interest received on all of the SPVLs of a payor of record held by the interest recipient to determine whether the $600 threshold is met. Therefore, an interest recipient need not report interest of less than $600 received on an SPVL, even though it receives a total of $600 or more of interest on all of the SPVLs of the payor of record for a calendar year.

(2) *Interest accrued by January 15*. An interest recipient may treat interest received during the current calendar year that properly accrues by January 15 of the subsequent calendar year as interest received for the current calendar

year. For example, if an interest recipient receives a monthly interest payment on December 31, Year 1, that includes interest accruing for the period December 5, Year 1, to January 5, Year 2, the interest recipient may treat the entire interest payment as received in Year 1. If a portion of the interest for which a payment received in a calendar year accrues after January 15 of the subsequent calendar year, an interest recipient must report as interest received for the current calendar year only the portion that properly accrues by the end of the current calendar year. For example, if an interest recipient receives a monthly payment that includes interest accruing for the period December 20, Year 1, through January 20, Year 2, the interest recipient may not report as interest received for Year 1 any interest accruing after December 31, Year 1. The interest recipient must report the interest accruing after December 31, Year 1, as received for calendar Year 2.

(g) *Requirement to file a return*—(1) *Form of the return*. An interest recipient must file a return required by paragraph (a) of this section on the form specified by the Secretary for this purpose, with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*. An interest recipient may use forms containing provisions substantially similar to those in the forms specified by the Secretary for this purpose if it complies with applicable revenue procedures relating to those forms. An interest recipient must file a separate return for each SPVL for which it receives $600 or more of interest for a calendar year.

(2) *Information included on the return*. An interest recipient must include on the form specified by the Secretary for this purpose—

(i) The name, address, and taxpayer identification number of the payor of record;

(ii) The name, address, and taxpayer identification number of the interest recipient;

(iii) The amount of interest received for the calendar year;

(iv) The amount of outstanding principal on the SPVL as of the beginning of the calendar year;

(v) The date of the origination of the SPVL;

(vi) The year, make, model, and vehicle identification number of the APV that secures the SPVL;

(vii) The date the SPVL was acquired; and

(viii) Any other information required by the form specified by the Secretary for this purpose or its instructions.

(3) *Time and place for filing the return; cross-references to penalty and electronic filing requirements*. An interest recipient must file a return required by paragraph (a) of this section on or before February 28 (March 31 if filed electronically) of the year following the calendar year for which it receives the interest. An interest recipient must file the return required by paragraph (a) of this section with the IRS office designated in the instructions for the form. For provisions relating to the penalty provided for the failure to file a correct information return required by paragraph (a) of this section, see § 301.6721-1 of this chapter. See § 301.6724-1 of this chapter for the waiver of a penalty if the failure is due to reasonable cause and not due to willful neglect. See § 301.6011-2(b) of this chapter for the requirement to submit the information returns required by this section electronically.

(h) *Requirement to furnish a statement*—(1) *In general*. An interest recipient that must file a return under paragraph (a) of this section must furnish a statement to the payor of record.

(2) *Information included on the statement*. An interest recipient must include on the statement that it furnishes to the payor of record—

(i) The name, address, and phone number of the information contact of the person required to make such return;

(ii) The information required under paragraph (g)(2) of this section;

(iii) A legend that—

(A) Identifies the statement as important tax information that is being furnished to the IRS; and

(B) Notifies the payor of record that if the payor of record is required to file a return, a negligence penalty or other sanction may be imposed if the IRS determines that an underpayment of tax results because the payor of record overstated a deduction for this interest (if any) on the payor of record's return; and

(iv) A legend stating that the payor of record may be unable to deduct the full amount of SPVL interest reported on the statement; that limitations based on the payor of record's modified adjusted gross income may apply; and that the payor of record may deduct QPVLI only to the extent the SPVL was incurred by, and the QPVLI was actually paid by, the payor of record.

(3) *Copy of the form determined by the Secretary to the payor of record*. An interest recipient will satisfy the requirement of paragraph (h)(1) of this section by furnishing to a payor of record a copy of the form determined by the Secretary (or substitute statement that complies with applicable revenue procedures) containing all the information filed with the IRS and all the legends required by paragraph (h)(2) of this section.

(4) *Furnishing the statement with other information returns*. An interest recipient may transmit the statement required by paragraph (h)(1) of this section to the payor of record with other information, including other information returns, as permitted by applicable revenue procedures.

(5) *Time and place for furnishing the statement*. An interest recipient must furnish a statement required by paragraph (h)(1) of this section to the payor of record on or before January 31 of the year following the calendar year for which it receives the interest. The interest recipient will be considered to have furnished the statement to the payor of record if it mails the statement to the payor of record's last known address.

(i) *Applicability date*. This section applies to calendar years beginning after December 31, 2024, and before January 1, 2029.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805.

* * * * *

Par. 5. Section 301.6011-2 is amended by revising paragraph (b)(1) to read as follows:

§ 301.6011-2 Required use of electronic form.

* * * * *

(b) * * *

(1) If the use of Form 1042-S, Form 1094 series, Form 1095-B, Form 1095-C, Form 1097-BTC, Form 1098, Form 1098-C, Form 1098-E, Form 1098-Q, Form 1098-T, Form 1098-VLI, Form 1099 series, Form 3921, Form 3922, Form 5498 series, Form 8027, or Form W-2G is required by the applicable regulations or revenue procedures for the purpose of making an information return, the information required by the form must be submitted electronically, except as otherwise provided in paragraph (c) of this section. Returns filed electronically must be made in accordance with applicable revenue procedures, publications, forms, or instructions.

* * * * *

Par. 6. Section 301.6721-1 is amended by:

1. Revising paragraphs (h)(3)(xxvi) and (xxvii);
2. Adding paragraph (h)(3)(xxviii); and
3. Adding paragraph (j)(2)(iii).

The additions and revision read as follows:

§ 301.6721-1 Failure to file correct information returns.

* * * * *

(h) * * *

(3) * * *

(xxvi) Section 6050Y (relating to returns relating to certain life insurance contract transactions);

(xxvii) Section 6050Z (relating to reports relating to long-term care premium statements); or

(xxviii) Section 6050AA (relating to returns relating to qualified passenger vehicle loan interest received in trade or business from individuals).

* * * * *

(j) * * *

(2) * * *

(iii) Paragraph (h)(3)(xxviii) of this section applies with respect to information returns required to be filed after December 31, 2024.

Par. 7. Section 301.6722-1 is amended by:

1. Revising paragraphs (e)(2)(xxxvii) and (xxxviii);
2. Adding paragraph (e)(2)(xxxix); and
3. Adding paragraph (g)(2)(iii).

The additions and revision read as follows:

§ 301.6722-1 Failure to furnish correct payee statements.

* * * * *

(e) * * *

(2) * * *

(xxxvii) Section 6226(a)(2) (regarding statements relating to alternative to payment of imputed underpayment by a partnership) or under any other provision of this title 26 that provides for the application of rules similar to section 6226(a)(2);

(xxxviii) Section 6050Z (relating to reports relating to long-term care premium statements); or

(xxxix) Section 6050AA (relating to returns relating to qualified passenger vehicle loan interest received in trade or business from individuals).

* * * * *

(g) * * *

(2) * * *

(iii) Paragraph (e)(2)(xxxix) of this section applies with respect to payee statements required to be furnished after December 31, 2024, and before January 1, 2029.

Frank J. Bisignano,
Chief Executive Officer.

Approved: July 27, 2026.

Kevin M. Salinger,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register September 4, 2026, 8:45 a.m., and published in the issue of the Federal Register for September 8, 2026, 91 FR 57214)

Part III

26 CFR 601.204: Changes in Accounting Periods and in Methods of Accounting
(Also: Part I, §§ 174, 174A, 446, 460; 1.446-1, 1.460-4)

Rev. Proc. 2026-32

SECTION 1. PURPOSE

This revenue procedure modifies section 7 of Rev. Proc. 2025-23, 2025-24 I.R.B. 1476, as modified by Rev. Proc. 2025-28, 2025-38 I.R.B. 393, with respect to the procedures under § 446 of the Internal Revenue Code (Code)[1] and § 1.446-1(e) for obtaining automatic consent of the Commissioner of Internal Revenue (Commissioner) to change methods of accounting for research or experimental expenditures (i) to comply with § 174, as in effect after amendment by § 13206(a) of Public Law 115-97, 131 Stat. 2054 (Dec. 22, 2017), commonly known as the Tax Cuts and Jobs Act (TCJA), and prior to amendment by § 70302(b)(1) of Public Law 119-21, 139 Stat. 189, 239 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), and (ii) to comply with §§ 174 and 174A, as amended and enacted by the OBBBA, respectively.

This revenue procedure also modifies section 19 of Rev. Proc. 2025-23 with respect to the procedures under § 446 and § 1.446-1(e) for obtaining automatic consent of the Commissioner to change methods of accounting for contracts entered into in taxable years beginning after July 4, 2025, to comply with § 460(e), as amended by the OBBBA.

SECTION 2. BACKGROUND

.01 *Certain references used in section 2 of this revenue procedure*.

(1) *References to § 70302 of the OBBBA*. All references hereinafter in section 2 of this revenue procedure to "OBBBA § 70302" refer to provisions of § 70302 of the OBBBA.

(2) *References to § 70430 of the OBBBA*. All references hereinafter in section 2 of this revenue procedure to "OBBBA § 70430" refer to provisions of § 70430 of the OBBBA.

(3) *References to § 174*. All references hereinafter in section 2 of this revenue procedure to "TCJA § 174" refer to § 174, as in effect after amendment by § 13206(a) of the TCJA, and prior to amendment by OBBBA § 70302(b)(1). All references hereinafter in section 2 of this revenue procedure to "§ 174" refer to § 174 as amended by OBBBA § 70302(b)(1).

(4) *References to research or experimental expenditures*. All references hereinafter in section 2 of this revenue procedure to "specified research or experimental expenditures" and "SRE expenditures" refer to research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and before January 1, 2025, under TCJA § 174. All references hereinafter in section 2 of this revenue procedure to "domestic research or experimental expenditures under TCJA § 174" refer to SRE expenditures other than SRE expenditures attributable to foreign research (within the meaning of § 41(d)(4)(F)).

.02 *Treatment of research or experimental expenditures under TCJA § 174*.

(1) *In general*. For expenditures paid or incurred in taxable years beginning after December 31, 2021, TCJA § 174 requires taxpayers to charge SRE expenditures to capital account and allows amortization deductions of such capitalized expenditures ratably over a 5-year period in the case of SRE expenditures attributable to domestic research, or a 15-year period in the case of SRE expenditures attributable to foreign research (within the meaning of § 41(d)(4)(F)), beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. The procedures in sections 7.01 and 7.03 of Rev. Proc. 2025-23, as modified by this revenue procedure, provide automatic changes in method of accounting for SRE expenditures under TCJA § 174 for amounts paid or incurred in taxable years beginning before January 1, 2025.

(2) *Treatment of foreign research or experimental expenditures under § 174*. OBBBA § 70302(b)(1) amended TCJA § 174 to provide that § 174 applies only to foreign research or experimental expenditures and that such expenditures continue to be charged to capital account and amortized ratably over a 15-year period beginning with the midpoint of the taxable year in which such expenditures are paid or incurred. Under § 174(b), as amended by OBBBA § 70302(b)(1)(B), "foreign research or experimental expenditures" are research or experimental expenditures that are paid or incurred by the taxpayer during a taxable year in connection with the taxpayer's trade or business that are attributable to foreign research (within the meaning of § 41(d)(4)(F)). OBBBA § 70302(e)(1) provides that the OBBBA amendments to TCJA § 174 apply to amounts paid or incurred in taxable years beginning after December 31, 2024.

(3) *Treatment of domestic research or experimental expenditures under § 174A*. OBBBA § 70302(a) amended part VI of subchapter B of chapter 1 of the Code by adding § 174A applicable to taxable years beginning after December 31, 2024. Section 174A(a) provides that, notwithstanding § 263, a deduction is allowed for any domestic research or experimental expenditures that are paid or incurred by the taxpayer during the taxable year. Section 174A(b) provides that, for purposes of § 174A, the term "domestic research or experimental expenditures" means research or experimental expenditures paid or incurred by the taxpayer in connection with the taxpayer's trade or business other than such expenditures that are attributable to foreign research (within the meaning of § 41(d)(4)(F)). Section 174A(c)(1) allows a taxpayer to make an election, in the case of domestic research or experimental expenditures that would (but for § 174A(a)) be chargeable to capital account but not chargeable to property of a character that is subject to the allowance under § 167 (relating to allowance for depreciation, etc.) or § 611 (relating to allowance for depletion), to charge such expenditures to capital account and amortize such expenditures ratably over a

[1] Unless otherwise specified, all "section" or "§" references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

period of not less than 60 months, beginning with the month in which the taxpayer first realizes benefits from such expenditures. Under § 174A(c)(1), such election is made in accordance with regulations or other guidance provided by the Secretary of the Treasury or the Secretary's delegate (Secretary). Section 174A(c)(2) provides that the election described in § 174A(c)(1) may be made for any taxable year, but only if made no later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The procedures in section 6 of Rev. Proc. 2025-28 provide guidance on making an election under § 174A(c) for expenditures paid or incurred in taxable years beginning after December 31, 2024. OBBBA § 70302(e)(1) provides that, generally, the amendments made by OBBBA § 70302 to add § 174A to the Code apply to amounts paid or incurred in taxable years beginning after December 31, 2024.

.03 *Treatment of Certain Construction Contracts under § 460.*

(1) *Section 460 in general*. Section 460(a) generally requires taxpayers to use the percentage-of-completion method to determine taxable income from a long-term contract. Section 460(f)(1) defines a "long-term contract" as any contract for the manufacture, building, installation, or construction of property if such contract is not completed within the taxable year in which such contract is entered into. Under § 460(e), the requirement to use the percentage-of-completion method and comply with associated rules does not apply to certain types of construction contracts (exempt construction contracts). Section 460(e)(3) defines a "construction contract" as any contract for the building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvements of, real property.

(2) *Treatment of home construction contracts, residential construction contracts, and other construction contracts prior to OBBBA*.

(a) *Exempt construction contracts*. Prior to amendment by the OBBBA, § 460(e)(1)(A) exempted taxpayers from the requirement to use the percentage-of-completion method for home construction contracts. Section 460(e)(1)(B) exempted taxpayers (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under § 448(a)(3)) from the requirement to use the percentage-of-completion method for any other construction contract if (i) the taxpayer estimated at the time the contract was entered into that the contract would be completed within the 2-year period beginning on the contract commencement date, and (ii) the taxpayer met the gross receipts test of § 448(c) for the taxable year in which the contract was entered into (small taxpayer exception).

(b) *Home construction contracts*. Section 460(e)(4)(A), as previously contained in § 460(e)(5)(A) prior to amendment by the OBBBA, defines the term "home construction contract" as any construction contract if 80 percent of the estimated total contract costs (as of the close of the taxable year in which the contract was entered into) are reasonably expected to be attributable to the building, construction, reconstruction, or rehabilitation of (i) dwelling units in buildings containing four or fewer units and (ii) improvements to real property directly related to the dwelling units and located on the site of the dwelling units. For purposes of § 460(e)(4)(A)(i), as previously contained in § 460(e)(5)(A)(i) prior to amendment by the OBBBA, each townhouse or rowhouse is treated as a separate building. Taxpayers were permitted to account for home construction contracts using any exempt contract method under § 1.460-4(c). Permissible exempt contract methods include the percentage-of-completion method, the exempt-contract percentage-of-completion-method (as described in § 1.460-4(c)(2)), the completed contract method (as described in § 1.460-4(d)), and any other permissible method. Under § 460(e)(1), taxpayers were required to apply § 263A to home construction contracts not accounted for under the percentage-of-completion method unless (i) the taxpayer estimated at the time the contract was entered into that the contract would be completed within the 2-year period beginning on the contract commencement date, and (ii) the taxpayer met the gross receipts test of § 448(c) for the taxable year in which the contract was entered into.

(c) *Residential construction contracts*. Section 460(e)(4)(B), as previously contained in § 460(e)(5)(B) prior to amendment by the OBBBA, defines the term "residential construction contract" as any contract that would be a home construction contract but for the limit on the number of dwelling units in a building. Under § 460(e)(4), prior to its repeal by the OBBBA, taxpayers with residential construction contracts that were not home construction contracts were permitted to account for such contracts using the percentage-of-completion/capitalized-cost method under which the percentage-of-completion method was used for 70 percent of contract income and contract costs and an exempt contract method was used for 30 percent of contract income and contract costs.

(2) *OBBBA amendments to § 460(e)*. The OBBBA did not modify the definitions of home construction contract or residential construction contract under § 460(e). OBBBA § 70430(a)(1)(A) amended § 460(e)(1)(A) to extend the home construction contract exception to the requirement to use the percentage-of-completion method to apply to all residential construction contracts. Similarly, OBBBA § 70430(a)(1)(B) amended § 460(e)(1) to extend the requirement to apply § 263A to a home construction contract that is not accounted for under the percentage-of-completion method to apply to all residential construction contracts unless (i) the taxpayer estimates at the time the contract is entered into that the contract will not be completed within the 2-year period beginning on the contract commencement date (3-year period beginning on the contract commencement date for residential construction contracts that are not home construction contracts), and (ii) the taxpayer meets the gross receipts test of § 448(c) for the taxable year in which the contract is entered into. OBBBA § 70430(a)(2) removed § 460(e)(4) from the Code, thereby eliminating the ability to use the percentage-of-completion/capitalized-cost method for residential construction contracts. OBBBA § 70430(c) provides that the amendments to § 460(e) are effective for contracts entered into in taxable years beginning after July 4, 2025.

.04 *Procedural guidance under Rev. Proc. 2025-28*.

(1) Revenue Procedure 2025-28 was released on August 28, 2025, to provide

procedures for making certain elections under OBBBA § 70302(f) with respect to domestic research or experimental expenditures. Rev. Proc. 2025-28 also modifies procedures under § 446 and § 1.446-1(e) for obtaining automatic consent to change methods of accounting for research or experimental expenditures under TCJA § 174 and §§ 174 and 174A.

(2) Section 7 of Rev. Proc. 2025-28 modifies section 7 of Rev. Proc. 2025-23 in three ways. First, section 7.01 of Rev. Proc. 2025-23 is modified to provide a change in method of accounting for domestic research or experimental expenditures under TCJA § 174. Second, section 7.02 of Rev. Proc. 2025-23 is modified to provide a change in method of accounting for domestic research or experimental expenditures under § 174A and to make certain transition method changes under the OBBBA. Third, section 7.03 of Rev. Proc. 2025-23 is added to provide a change in method of accounting for foreign SRE expenditures under TCJA § 174 and foreign research or experimental expenditures under § 174.

.05 *Changing methods of accounting under § 446(e)*.

(1) *In general*. Except as otherwise expressly provided in the Code and the regulations thereunder, § 446(e) and § 1.446-1(e)(2) require a taxpayer to secure the consent of the Commissioner before changing a method of accounting for Federal income tax purposes. Section 1.446-1(e)(3)(i) provides, in part, that except as otherwise provided under the authority of § 1.446-1(e)(3)(ii), to secure the Commissioner's consent to a taxpayer's change in method of accounting the taxpayer generally must file a Form 3115, *Application for Change in Accounting Method*, with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures under which taxpayers will be permitted to change their method of accounting. The administrative procedures prescribe those terms and conditions necessary to obtain the Commissioner's consent to effect the change and to prevent amounts from being duplicated or omitted.

(2) *Current guidance on changing methods of accounting*. Rev. Proc. 2015-13, 2015-5 I.R.B. 419, as clarified and modified by Rev. Proc. 2015-33, 2015-24 I.R.B. 1067, and as modified by Rev. Proc. 2021-34, 2021-35 I.R.B. 337, Rev. Proc. 2021-26, 2021-22 I.R.B. 1163, Rev. Proc. 2017-59, 2017-48 I.R.B. 543, and section 17.02(b) and (c) of Rev. Proc. 2016-1, 2016-1 I.R.B. 1, sets forth the general administrative procedures by which a taxpayer may obtain the automatic consent of the Commissioner to change a method of accounting described in the *List of Automatic Changes*. Rev. Proc. 2025-23 contains the current *List of Automatic Changes*.

(3) *Changes in method of accounting for research or experimental expenditures under TCJA § 174, § 174, and § 174A*.

(a) A change in the treatment of SRE expenditures to comply with TCJA § 174 is a change in method of accounting to which §§ 446(e) and 481, and the corresponding regulations, apply. Similarly, a change in a taxpayer's treatment of foreign or domestic research or experimental expenditures to comply with § 174 or § 174A, respectively, or to use certain transition options provided in OBBBA § 70302(f), is a change in method of accounting to which §§ 446(e) and 481, and the corresponding regulations, apply.

(b) A taxpayer that changes its method of accounting to comply with TCJA § 174, § 174, or § 174A must use the accounting method change procedures in Rev. Proc. 2015-13 or its successor.

(c) Section 3.01 and .02 of this revenue procedure modify section 7.01 of Rev. Proc. 2025-23 (relating to a change in method of accounting for domestic research or experimental expenditures under TCJA § 174) as follows:

(i) To provide that, if a taxpayer previously changed to the recovery of unamortized amount method described in section 7.02(2)(f) of Rev. Proc. 2025-23 for a prior taxable year, the taxpayer's § 481(a) adjustment for a change under section 7.01 of Rev. Proc. 2025-23 must reflect application of the taxpayer's recovery of unamortized amount method;

(ii) To provide that, if a taxpayer makes both a change under section 7.01 and section 7.02(2)(f) of Rev. Proc. 2025-23 for its first taxable year beginning after December 31, 2024, the § 481(a) adjustment period for any net positive § 481(a) adjustment resulting from the change under section 7.01 of Rev. Proc. 2025-23 is the same amortization period elected by the taxpayer under its recovery of unamortized amount method (that is, the net positive § 481(a) adjustment is taken into account either in full in the first taxable year beginning after December 31, 2024, or ratably over the 2-taxable year period beginning with the first taxable year beginning after December 31, 2024);

(iii) To provide that, if a taxpayer previously made a change under section 7.02(2)(f) of Rev. Proc. 2025-23 for a taxable year prior to its year of change for a change under section 7.01 of Rev. Proc. 2025-23, the § 481(a) adjustment period for any net positive § 481(a) adjustment resulting from the change under section 7.01 of Rev. Proc. 2025-23 is taken into account over the amortization period remaining under the taxpayer's recovery of unamortized amount method; and

(iv) To extend the waiver of the eligibility rules in section 5.01(d) and (f) of Rev. Proc. 2015-13 for any change in method of accounting described in section 7.01(1)(a) of Rev. Proc. 2025-23 for any taxable year beginning before 2028.

(d) Section 3.03 of this revenue procedure modifies section 7.02 of Rev. Proc. 2025-23 (relating to a change in method of accounting for domestic research or experimental expenditures under the OBBBA, including certain transition options) to extend the waiver of the eligibility rules in section 5.01(d) and (f) of Rev. Proc. 2015-13 for any change in method of accounting described in section 7.02(3) of Rev. Proc. 2025-23 for any taxable year beginning before 2028.

(e) Section 3.04 and .05 of this revenue procedure modify section 7.03 of Rev. Proc. 2025-23 (relating to a change in method of accounting for foreign research or experimental expenditures) as follows:

(i) To remove the limitation on the applicability of a change in method of accounting for foreign research or experimental expenditures to comply with § 174 that currently limits such change to taxable years beginning before January 1, 2026; and

(ii) To extend the waiver of the eligibility rules in section 5.01(d) and (f) of Rev. Proc. 2015-13 for any change in method of accounting described in section 7.03(1)

(a) of Rev. Proc. 2025-23 for any taxable year beginning before 2028.

(4) *Changes in method of accounting for residential construction contracts under OBBBA*.

(a) A change from the percentage-of-completion method described in § 1.460-4(b) or the percentage-of-completion/capitalized-cost method described in § 1.460-4(e) to an exempt contract method described in § 1.460-4(c) for residential construction contracts to comply with § 460(e)(1)(A) is a change in method of accounting to which §§ 446(e) and 481, and the corresponding regulations, apply. Similarly, a change to start or stop capitalizing costs under § 263A for residential construction contracts to comply with § 460(e)(1) is a change in method of accounting to which §§ 446(e) and 481, and the corresponding regulations, apply.

(b) A taxpayer that changes its method of accounting to comply with § 460(e)(1) or to start or stop capitalizing costs under § 263A pursuant to § 460(e)(1) must use the accounting method change procedures in Rev. Proc. 2015-13 (or its successor).

(c) Section 4.01 of this revenue procedure modifies section 19.01 of Rev. Proc. 2025-23 to allow a taxpayer to obtain automatic consent to stop capitalizing costs under § 263A for residential construction contracts that meet the requirements of § 460(e)(1)(B)(i) and (ii).

(d) Section 4.02 of this revenue procedure adds section 19.03 of Rev. Proc. 2025-23, to allow a taxpayer to obtain automatic consent to change its method of accounting for residential construction contracts that are entered into in taxable years beginning after July 4, 2025, (1) from the percentage-of-completion method of accounting or the percentage-of-completion/capitalized-cost method of accounting to an exempt contract method of accounting, or (2) to start capitalizing costs under § 263A for contracts that do not meet the requirements of § 460(e)(1)(B)(i) and (ii).

SECTION 3. MODIFICATION OF SECTION 7 OF REV. PROC. 2025-23

.01 *Modification of section 7.01(3)(a) of Rev. Proc. 2025-23*. Section 7.01(3)(a) of Rev. Proc. 2025-23 is modified to read as follows:

(a) *Modified § 481(a) adjustment and cut-off*.

(i) *In general*. Except as provided in section 7.01(3)(a)(ii) of this revenue procedure, the change under section 7.01(1)(a) of this revenue procedure is made with a modified § 481(a) adjustment that takes into account only expenditures paid or incurred in taxable years beginning after December 31, 2021, and before January 1, 2025. If the taxpayer previously changed to the recovery of unamortized amounts method described in section 7.02(2)(f) of this revenue procedure for a prior taxable year, the § 481(a) adjustment for the change under this section 7.01 must reflect application of the taxpayer's recovery of unamortized amount method.

(ii) *Exception for negative modified § 481(a) adjustment*. If a change described in section 7.01(3)(a)(i) of this revenue procedure results in a modified § 481(a) adjustment that is negative, the taxpayer may instead choose to implement the change on a cut-off basis.

(iii) *Section 481(a) adjustment period*.

(A) *Concurrent change to the recovery of unamortized amount method*. If a taxpayer makes both a change under this section 7.01 and a change to the recovery of unamortized amount method described in section 7.02(2)(f) of this revenue procedure for its first taxable year beginning after December 31, 2024, the § 481(a) adjustment period for any net positive § 481(a) adjustment for the change under this section 7.01 is the same amortization period elected by the taxpayer under the recovery of unamortized amount method; that is, the net positive § 481(a) adjustment is either taken into account in full in the first taxable year beginning after December 31, 2024, or ratably over the 2-taxable year period beginning with the first taxable year beginning after December 31, 2024.

(B) *Previous change to the recovery of unamortized amount method*. If the taxpayer previously changed to the recovery of unamortized amounts method described in section 7.02(2)(f) of this revenue procedure for a prior taxable year, any net positive § 481(a) adjustment for the change under this section 7.01 is taken into account over the amortization period that remains under the taxpayer's recovery of unamortized amount method.

.02 *Modification of section 7.01(5) of Rev. Proc. 2025-23*. Section 7.01(5) of Rev. Proc. 2025-23 is modified to read as follows:

(5) *Certain eligibility rules inapplicable*.

(a) *In general*. The eligibility rules in section 5.01(1)(d) and (f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, do not apply to a change described in section 7.01(1)(a) of this revenue procedure for any taxable year beginning before January 1, 2028.

(b) *Changes made in successive taxable years*. A taxpayer may make a change described in section 7.01(1)(a) of this revenue procedure for which it has used an impermissible method of accounting for only one taxable year (that is, for which it has used an impermissible method of accounting in the taxable year prior to the year of change).

.03 *Modification of section 7.02(7) of Rev. Proc. 2025-23*. Section 7.02(7) of Rev. Proc. 2025-23 is modified to read as follows:

(7) *Certain eligibility rules inapplicable*. The eligibility rules in section 5.01(1)(d) and (f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, do not apply to a change described in section 7.02(3) of this revenue procedure for any taxable year beginning before January 1, 2028.

.04 *Modification of section 7.03(1)(a) of Rev. Proc. 2025-23*. Section 7.03(1)(a) of Rev. Proc. 2025-23 is modified to read as follows:

(1) *Description of change*.

(a) *In general*. This change applies to a taxpayer (applicant) that wants to change its method of accounting for foreign SRE expenditures or foreign research or experimental expenditures, as applicable, paid or incurred in taxable years beginning after December 31, 2021, to:

(i) comply with TCJA § 174 for expenditures paid or incurred in taxable years beginning before January 1, 2025;

(ii) rely on interim guidance provided in section 3, 4, 5, 6, or 7 of Notice 2023-63, 2023-39 I.R.B. 919, as modified by Notice 2024-12, 2024-5 I.R.B. 616; or

(iii) comply with the changes made to § 174 by the OBBBA for expenditures paid or incurred in taxable years beginning after December 31, 2024.

.05 *Modification of section 7.03(5) of Rev. Proc. 2025-23*. Section 7.03(5) of

Rev. Proc. 2025-23 is modified to read as follows:

(5) *Certain eligibility rules inapplicable*.

(a) *In general*. The eligibility rules in section 5.01(1)(d) and (f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, do not apply to a change described in section 7.03(1)(a) of this revenue procedure made by a taxpayer for any taxable year beginning before January 1, 2028.

(b) *Changes made in successive taxable years*. A taxpayer may make a change described in section 7.03(1)(a) of this revenue procedure for which it has used an impermissible method of accounting for only one taxable year (that is, for which the taxpayer has used an impermissible method of accounting in the taxable year prior to the year of change).

SECTION 4. MODIFICATION OF SECTION 19 OF REV. PROC. 2025-23

.01 Section 19.01 is modified to read as follows:

.01 *Small business taxpayer exceptions from requirement to account for certain long-term construction contracts under § 460 or to capitalize costs under § 263A for certain contracts*.

(1) *Description of change*. This change applies to a taxpayer that wants to change its method of accounting:

(a) For exempt construction contracts described in § 460(e)(1)(B), from the percentage-of-completion method of accounting described in § 1.460-4(b) to an exempt contract method of accounting described in § 1.460-4(c);

(b) For contracts entered into in taxable years beginning on or before July 4, 2025, to stop capitalizing costs under § 263A for home construction contracts described in § 460(e)(1)(A), as in effect prior to amendment by Public Law 119-21, 139 Stat. 189 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA), that meet the requirements of § 460(e)(1)(B)(i) and (ii); or

(c) For contracts entered into in taxable years beginning after July 4, 2025, to stop capitalizing costs under § 263A for residential construction contracts described in § 460(e)(1)(A), as amended by the OBBBA, that meet the requirements of § 460(e)(1)(B)(i) and (ii).

(2) *Inapplicability*. This change does not apply in the first taxable year in which a taxpayer enters into a particular type of contract for which the taxpayer may adopt a permissible method of accounting. For example, the change described in section 19.01(1)(a) of this revenue procedure does not apply in the first taxable year in which the taxpayer enters into a nonresidential long-term construction contract that meets the requirements of § 460(e)(1)(B). In such case, the adoption of a permissible exempt contract method of accounting described in § 1.460-4(c) for such contract is not a change in method of accounting under § 446(e) and § 1.446-1(e)(2). *See* Rev. Rul. 92-28, 1992-1 C.B. 153.

(3) *Manner of making change*. This change is made on a cut-off basis and applies only to contracts entered into on or after the first day of the year of change that are subject to the method change. Accordingly, a § 481(a) adjustment is neither permitted nor required.

(4) *Reduced filing requirement*. A taxpayer is required to complete only the following information on Form 3115 (Rev. December 2022) to make this change:

(a) The identification section of page 1 (above Part I);

(b) The signature section at the bottom of page 1;

(c) Part I;

(d) Part II, all lines except line 16;

(e) Part IV, line 25; and

(f) Schedule D, Part I.

(5) *Certain eligibility rules inapplicable*. The eligibility rules in section 5.01(1)(d) and (f) of Rev. Proc. 2015-13 do not apply to a change described in section 19.01(1)(c) of this revenue procedure for the taxpayer's first or second taxable year beginning after July 4, 2025.

(6) *Designated automatic accounting method change number*. The designated automatic accounting method change number for a change under this section 19.01 is "236."

(7) *Contact information*. For further information regarding changes under this section, contact Michael Finn at (202) 317-4718 (not a toll-free number).

.02 Section 19.03 of Rev. Proc. 2025-23 is added to read as follows:

.03 *Certain residential construction contracts excepted from the requirement under § 460 and subject to capitalization under § 263A*.

(1) *Description of change*. This change applies to a taxpayer that wants to change its method of accounting for residential construction contracts (as defined in § 460(e)(4)(B)) that are entered into in taxable years beginning after July 4, 2025:

(a) From the percentage-of-completion method of accounting described in § 1.460-4(b) or the percentage-of-completion/capitalized-cost method of accounting described in § 1.460-4(e) to an exempt contract method of accounting described in § 1.460-4(c); or

(b) To start capitalizing costs under § 263A for contracts that do not meet the requirements of § 460(e)(1)(B)(i) and (ii).

(2) *Inapplicability*. This change does not apply in the first taxable year in which a taxpayer enters into a particular type of contract for which the taxpayer may adopt a permissible method of accounting. For example, the change described in section 19.03(1)(a) of this revenue procedure does not apply in the first taxable year in which a taxpayer enters into a residential construction contract as defined in § 460(e)(4)(B). In such cases, the adoption of a permissible exempt contract method of accounting described in § 1.460-4(c) for such contracts is not a change in method of accounting under § 446(e) and § 1.446-1(e)(2).

(3) *Manner of making change*. This change is made on a cut-off basis and applies only to contracts entered into on or after the first day of the year of change that are subject to the method change. Accordingly, a § 481(a) adjustment is neither permitted nor required.

(4) *Reduced filing requirement*. A taxpayer is required to complete only the following information on Form 3115 (Rev. December 2022) to make this change:

(a) The identification section of page 1 (above Part I);

(b) The signature section at the bottom of page 1;

(c) Part I;

(d) Part II, all lines except line 16;

(e) Part IV, line 25; and

(f) Schedule D, Part I.

(5) *Transition rule*. If, on or before September 21, 2026, a taxpayer filed a Federal income tax return for a taxable year beginning after July 4, 2025, the tax-

payer is deemed to have complied with the general procedures under § 446(e), § 1.446-1(e), and this section 19.03 to change its method of accounting for contracts described in section 19.03(1) of this revenue procedure if the taxpayer properly applied the methods of accounting provided in section 19.03(1)(a) or (b), respectively, of this revenue procedure for such taxable year.

(6) *Certain eligibility rules inapplicable*. The eligibility rules in section 5.01(1)(d) and (f) of Rev. Proc. 2015-13 do not apply to a change described in this section 19.03 for the taxpayer's first or second taxable year beginning after July 4, 2025.

(7) *Designated automatic accounting method change number*. The designated automatic accounting method change number for a change under this section 19.03 is "275."

(8) *Contact information*. For further information regarding changes under this section, contact Michael Finn at (202) 317-4718 (not a toll-free number).

SECTION 5. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies sections 7 and 19 of Rev. Proc. 2025-23.

SECTION 6. EFFECTIVE DATE

.01 *In general*. Except as otherwise provided in this section 6, sections 7, 19.01, and 19.03 of Rev. Proc. 2025-23, as modified by this revenue procedure, are effective for a Form 3115 filed after September 4, 2026.

.02 *Transition rule for taxpayers that properly file the duplicate copy of Form 3115 on or before November 15, 2026, for a change described in sections 7 and 19.01 of Rev. Proc. 2025-23, prior to modification by this revenue procedure*.

(1) *In general*. If, on or before November 15, 2026, a taxpayer properly files the duplicate copy of a Form 3115 for a change described in section 7 or 19.01 of Rev. Proc. 2025-23, prior to modification by this revenue procedure, the Form 3115 is not subject to the effective date provided in section 6.01 of this revenue procedure.

(2) *Option to implement change as described in sections 7 and 19.01 of Rev. Proc. 2025-23, as modified by this revenue procedure*. If, on or before November 15, 2026, a taxpayer properly files the duplicate copy of a Form 3115 for a change in method of accounting described in section 7 or 19.01 of Rev. Proc. 2025-23, prior to modification by this revenue procedure, that continues to be eligible for the automatic change procedures under section 7 or 19.01 of Rev. Proc. 2025-23, as modified by this revenue procedure, but has not filed its timely filed (including extensions) original Federal income tax return for the year of change implementing the change, the taxpayer may choose to implement the change as described in either (1) section 7 or 19.01 of Rev. Proc. 2025-23, prior to modification by this revenue procedure, or (2) section 7 or 19.01 of Rev. Proc. 2025-23, as modified by this revenue procedure, but not both.

(a) *Procedure to implement change as described in section 7 or 19.01 of Rev. Proc. 2025-23, prior to modification by this revenue procedure*. A taxpayer who meets the requirements of section 6.02(2) of this revenue procedure and chooses to implement the change as described in section 7 or 19.01 of Rev. Proc. 2025-23, prior to modification by the revenue procedure, is not required to resubmit a duplicate copy of the Form 3115 to the IRS in Ogden, UT. However, if requested by the Director, the taxpayer must provide written substantiation that the duplicate copy of the Form 3115 was filed on or before November 15, 2026, pursuant to section 6.03(1)(a)(i)(B) of Rev. Proc. 2015-13. Such written substantiation may include proof of mailing or faxing, as appropriate, of the duplicate copy of the Form 3115.

(b) *Procedure to implement the change as described in section 7 or 19.01 of Rev. Proc. 2025-23, as modified by this revenue procedure*. A taxpayer who meets the requirements of section 6.02(2) of this revenue procedure and chooses to implement the change as described in section 7 or 19.01 of this Rev. Proc. 2025-23, as modified by this revenue procedure, must resubmit a duplicate copy (with signature) of the Form 3115 to the IRS in Ogden, UT, for the year of change under this revenue procedure, pursuant to the requirements of section 6.03(1)(a)(i)(B) of Rev. Proc. 2015-13. The resubmitted duplicate copy must include the following statement on the top of page 1 of the Form 3115: "FILED UNDER REV. PROC. 2026-32, AS PROVIDED IN SECTION 6.02(2)(b) OF REV. PROC. 2026-32". For purposes of the eligibility rules in section 5 of Rev. Proc. 2015-13, the duplicate copy of the resubmitted Form 3115 will be considered filed as of the date the taxpayer originally filed the duplicate copy of the Form 3115 requesting the change under Rev. Proc. 2025-23, prior to modification by this revenue procedure. This section 6.02(2)(b) does not extend the date the taxpayer must file either the resubmitted duplicate copy or original Form 3115 under section 6.03(1)(a) of Rev. Proc. 2015-13. If requested by the Director, the taxpayer must provide written substantiation that the duplicate copy of the Form 3115 requesting the change under Rev. Proc. 2025-23, prior to modification by this revenue procedure, was filed on or before November 15, 2026, pursuant to section 6.03(1)(a)(i)(B) of Rev. Proc. 2015-13. Such written substantiation may include proof of mailing or faxing, as appropriate, of the duplicate copy of the Form 3115.

.03 *Limited time period to convert a Form 3115 filed under the non-automatic change procedures in Rev. Proc. 2015-13*.

(1) If, before September 21, 2026, a taxpayer properly filed a Form 3115 under the non-automatic change procedures in Rev. Proc. 2015-13 requesting the Commissioner's consent for a change in method of accounting described in section 7, 19.01, or 19.03 of Rev. Proc. 2025-23, as modified by this revenue procedure, and the Form 3115 is pending with the national office on September 21, 2026, the taxpayer may choose to make the change in method of accounting under the automatic change procedures in Rev. Proc. 2015-13 if the taxpayer is otherwise eligible to use the automatic method changes described in section 7, 19.01, or 19.03 of Rev. Proc. 2025-23, as modified by this revenue procedure, and the automatic change procedures in Rev. Proc. 2015-13. The taxpayer must notify the national office contact person for the Form 3115 (if unknown, fax the notification to 855-576-2341 or send the notification to the attention of Management Assistant (OA), CC:ITA:B07, Room 4136, at the address specified in section 9.08(6) of Rev. Proc. 2026-1, 2026-1 I.R.B. 1 (or any successor)), of

the taxpayer's intent to make the change in method of accounting under the automatic change procedures in Rev. Proc. 2015-13 before the later of (a) October 21, 2026, or (b) the issuance of a letter ruling granting or denying consent for the change. The notification should indicate that the taxpayer chooses to convert the Form 3115 to the automatic change procedures in Rev. Proc. 2015-13. If the taxpayer timely notifies the national office that it chooses to convert the Form 3115 to the automatic change procedures in Rev. Proc. 2015-13, the national office will send a letter to the taxpayer acknowledging its request and will return the user fee submitted with the Form 3115.

(2) A taxpayer converting a Form 3115 to the automatic change procedures in Rev. Proc. 2015-13 for a change in method of accounting described in section 7, 19.01, or 19.03 of Rev. Proc. 2025-23, as modified by this revenue procedure, must resubmit a Form 3115 that conforms to the automatic change procedures, with a copy of the national office letter sent acknowledging the taxpayer's request attached, to the IRS in accordance with section 9.06 of Rev. Proc. 2026-1 (or its successor), by the earlier of (a) the 30th calendar day after the date of the national office's letter acknowledging the taxpayer's request or (b) the date the taxpayer is required to file the duplicate copy of the Form 3115 under section 6.03(1)(a)(i)(B) of Rev. Proc. 2015-13. See section 6.03(3) of Rev. Proc. 2015-13 regarding additional required copies of Form 3115.

(3) For purposes of the eligibility rules in section 5 of Rev. Proc. 2015-13, the duplicate copy of the timely resubmitted Form 3115 will be considered filed as of the date the taxpayer originally filed the converted Form 3115 under the non-automatic change procedures in Rev. Proc. 2015-13. This section 6.03 does not extend the date the taxpayer must file the original (converted) Form 3115 under section 6.03(1)(a)(i)(A) of Rev. Proc. 2015-13.

(4) A Form 3115 filed under the non-automatic change procedures in Rev. Proc. 2015-13 before September 21, 2026, for a change in method of accounting described in sections 7, 19.01 and 19.03 of Rev. Proc. 2025-23, as modified by this revenue procedure, will be disregarded for purposes of the prior five-year change rules in section 5.04 and 5.05 of Rev. Proc. 2015-13 if the taxpayer converts the Form 3115 to the automatic change procedures pursuant to this section 6.03.

SECTION 7. PAPERWORK REDUCTION ACT

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

The collections of information in this revenue procedure are in section 3. This information is necessary and will be used to determine whether the taxpayer properly changed to an exempt contract method for exempt construction contracts under § 460 and properly changed to start or stop capitalizing costs to exempt construction contracts under § 263A.

These collection requirements are included in the OMB Control Number 1545-0074 for individual filers, 1545-0123 for business filers, 1545-0092 for trust and estate filers, and 1545-0047 for tax-exempt filers, in accordance with the PRA (44 U.S.C. 3507).

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Michael Finn from the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding a change under § 174 or § 174A, please contact Bruce Chang from the Office of Associate Chief Counsel (Income Tax & Accounting) at (202) 317-4870 (not a toll-free number). For further information regarding this revenue procedure or a change under § 460, please contact Mr. Finn at (202) 317-4718 (not a toll-free number).

Part IV

Deletions From Cumulative List of Organizations, Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2026-16

Table of Contents

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the IRS will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the IRS is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on August 27, 2026, and would end on the date the court first determines the organization is not described in section 170(c)(2) as more particularly set for in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Name Of Organization	Effective Date of Revocation	Location
Outreach International Global Ministries Inc	01/01/2022	Orlando, FL
Aamha Wurzbach Apartmetns Inc	01/01/2022	Santo Antonio, TX
Hamrick Community Foundation	01/01/2023	Akron, OH
S&S Associates Family Learning Center	01/01/2021	Levittown, PA
Gaaays in Spaaace	10/01/2021	Philadelphia, PA
Tuscarora High School PTSA	07/01/2022	Frederick, MD
Marcella Community Club	01/01/2023	Rockaway, NJ
Living Rock Family Outreach Inc	01/01/2022	Granville, OH
Safe Surgery Initiative Inc	03/01/2022	Buckeye, AZ
For the Fun of Fit Inc	01/01/2023	Fresno, CA
Women Economic Development Center	01/01/2021	Saint Paul, MN
James Cory Ministries Inc	01/01/2022	Pinellas Park, FL

Notice of Proposed Rulemaking

Pro Rata Share of Subpart F Income, Tested Income, or Tested Loss

REG-115646-25

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the determination of a United States shareholder's pro rata share of subpart F income, tested income, or tested loss of a controlled foreign corporation. The proposed regulations would affect shareholders of foreign corporations, including United States shareholders of controlled foreign corporations.

DATES: Written or electronic comments and requests for a public hearing must be received by October 26, 2026.

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-115646-25) by following the online instructions for submitting comments. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment submitted to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-115646-25), room 5503, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Dylan J. Steiner at (202) 317-6934; concerning submissions of comments and requests for a public hearing, contact the Publications and Regulations Section of the Office of Associate Chief Counsel (Procedure and Administration) by email at *publichearings@irs.gov* (preferred) or by telephone at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Authority

This document contains proposed additions and amendments to 26 CFR part 1 (proposed regulations) under sections 951 and 951A and certain other provisions of the Internal Revenue Code (Code) relating to the determination of a United States shareholder's pro rata share of subpart F income, tested income, or tested loss of a controlled foreign corporation. The proposed regulations also include guidance regarding the transition rule (transition rule) in section 70354(c)(2) of Public Law 119-21, 139 Stat. 72 (July 4, 2025), commonly known as the One, Big, Beautiful Bill Act (OBBBA). The proposed regulations are issued pursuant to the express delegations of authority in section 951(a)(4) and section 70354(c)(2) of the OBBBA. The proposed regulations are also issued pursuant to the express delegation of authority in section 7805(a).

Background

I. *Scope*

This Background describes the rules for determining a United States shareholder's pro rata share of subpart F income, tested income, or tested loss, as relevant, as well as certain other related provisions. Any term used but not defined in this preamble has the meaning given to it in the proposed regulations.

II. *Pro Rata Share Rules*

A. *Rules before OBBBA*

Former section 951(a)(1)(A), as in effect before amendments made by the OBBBA,[1] generally required a United States shareholder (U.S. shareholder) (as defined in section 951(b)) of a foreign corporation to include in gross income its pro rata share of the corporation's subpart F income (as defined in section 952) for a taxable year of the corporation if the corporation was a controlled foreign corporation (CFC) (as defined in section 957(a)) at any time during the taxable year and the shareholder owned stock of the corporation on the last day of the taxable year on which the corporation was a CFC (last relevant day). For this purpose, ownership of stock was determined under section 958(a) and thus included stock owned directly and stock owned indirectly through foreign corporations and other foreign entities (including certain domestic entities to the extent treated as foreign entities under §1.958-1(d)(1)).[2] Under former section 951(a)(1)(B), a U.S. shareholder was generally also required to include in gross income its amount determined under section 956 for the taxable year of the foreign corporation.

For purposes of former section 951(a)(1)(A), a U.S. shareholder's pro rata share of a CFC's subpart F income for a taxable year of the CFC was calculated by first determining the amount described in former section 951(a)(2)(A). This amount, which was determined based on the U.S. shareholder's proportionate share of a hypothetical distribution by the CFC, represented subpart F income (unreduced by distributions during the taxable year) allocable to stock of the CFC that the U.S. shareholder owned on the last relevant day. *See* §1.951-1(b) and (e). This amount was limited under former section 951(a)(2)(A) based on the portion of the taxable year during which the foreign corporation was a CFC. The amount determined under former section 951(a)(2)(A) was then reduced for certain distributions

[1] All references to former provisions under section 951 or 951A in this preamble are to the versions of those provisions as in effect before the amendments made by the OBBBA.

[2] For purposes of this preamble, a reference to stock ownership means stock owned within the meaning of section 958(a).

under former section 951(a)(2)(B) to arrive at the U.S. shareholder's pro rata share of the CFC's subpart F income. Former section 951(a)(2)(B) addressed cases in which stock of a CFC owned by a U.S. shareholder on the last relevant day was acquired by the U.S. shareholder during the CFC's taxable year by generally reducing the U.S. shareholder's pro rata share of the CFC's subpart F income by the amount of dividends received by any other person during the taxable year with respect to the acquired stock (but limited that reduction based on the portion of the CFC's taxable year during which the U.S. shareholder did not own the stock of the CFC).

Former section 951A(a) required a U.S. shareholder of a CFC to include in gross income its global intangible low-taxed income (GILTI inclusion amount). *See* §1.951A-1(b). A U.S. shareholder's GILTI inclusion amount was determined by taking into account the shareholder's pro rata share of tested items (as defined in §1.951A-1(f)(5)) of CFCs in which the shareholder owned stock, such as tested income, tested loss, and qualified business asset investment. *See* §1.951A-1(c). A U.S. shareholder's pro rata share of a CFC's tested items was determined in the same manner as a U.S. shareholder's pro rata share of a CFC's subpart F income under former section 951(a)(2), subject to certain modifications. *See* section 951A(e)(1) and §1.951A-1(d).

B. O*BBBA revisions*

1. Overview

The OBBBA amended sections 951(a) and 951A for taxable years of foreign corporations beginning after December 31, 2025. The OBBBA also provided the transition rule for certain taxable years before the amendments to sections 951(a) and 951A apply.

2. Revised Section 951(a)

As amended by the OBBBA, section 951(a)(1)(A) requires a U.S. shareholder of a foreign corporation to include in gross income the U.S. shareholder's pro rata share of the foreign corporation's subpart F income if the foreign corporation is a CFC at any time during the foreign corporation's taxable year (a CFC year) and the U.S. shareholder owns stock of the foreign corporation on any day during the CFC year. Thus, unlike pre-OBBBA law, a section 951(a)(1)(A) inclusion is not limited to U.S. shareholders that own stock in the CFC on the last relevant day. However, the OBBBA retains the last relevant day rule in section 951(a)(1)(B), under which a U.S. shareholder is generally required to include in gross income its amount determined under section 956.

For purposes of section 951(a)(1)(A), the OBBBA replaced the hypothetical distribution and reduction rules for determining a U.S. shareholder's pro rata share of subpart F income under former sections 951(a)(2)(A) and (B) with an approach that is instead based on the subpart F income attributable to the U.S. shareholder's ownership of stock of the foreign corporation during the CFC year. Specifically, section 951(a)(2) provides that a U.S. shareholder's pro rata share of a CFC's subpart F income is the portion of such income that is attributable to the stock of the foreign corporation owned by the shareholder and any period of the CFC year during which (i) the shareholder owned such stock, (ii) the shareholder was a U.S. shareholder of the corporation, and (iii) the corporation was a CFC.

The OBBBA also modified the time at which amounts determined under sections 951(a)(1)(A) and (B) are included in gross income by a U.S. shareholder. Under section 951(a)(3), any amount required to be included in gross income by a U.S. shareholder under section 951(a)(1)(A) or (B) with respect to a CFC year is included in gross income for the U.S. shareholder's taxable year that includes the last day on which the shareholder owns stock in the CFC during such CFC year.

Section 951(a)(4) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of section 951(a), including regulations or other guidance allowing taxpayers to elect, or requiring taxpayers, to close the taxable year of a CFC upon a direct or indirect disposition of stock of the corporation.

3. Revised Section 951A

As amended by the OBBBA, section 951A(a) requires each person that is a U.S. shareholder of a CFC for any taxable year of the U.S. shareholder to include in gross income the U.S. shareholder's net CFC tested income for the taxable year. Section 951A(b)(1) provides that net CFC tested income means, with respect to any U.S. shareholder for any taxable year of the U.S. shareholder, the excess (if any) of (i) the aggregate of the U.S. shareholder's pro rata share of the tested income of each CFC with respect to which the shareholder is a U.S. shareholder for the taxable year of the U.S. shareholder, over (ii) the aggregate of the U.S. shareholder's pro rata share of the tested loss of each CFC with respect to which the shareholder is a U.S. shareholder for the taxable year of the U.S. shareholder.

Section 951A(c) provides that the pro rata shares of tested income and tested loss referred to in section 951A(b)(1) are determined under the rules of section 951(a)(2) in the same manner as section 951(a)(2) applies to subpart F income and are taken into account in the taxable year of the U.S. shareholder determined under section 951(a)(3).

4. Transition Rule

For certain taxable years before the amendments to sections 951(a) and 951A made by the OBBBA apply, a U.S. shareholder determines its pro rata share of subpart F income and tested items under the transition rule. The transition rule provides that certain dividends are not treated as dividends for purposes of applying former section 951(a)(2)(B), except to the extent provided by the Secretary.

A dividend is subject to the transition rule if the dividend is (i) paid or deemed paid on or before June 28, 2025, and during the taxable year of a CFC that includes such date, provided the U.S. shareholder described in section 951(a) did not own (within the meaning of section 958(a)) the stock of the CFC during the portion of the taxable year on or before June 28, 2025, or (ii) paid or deemed paid after June 28, 2025, and before a foreign corporation's first taxable year beginning after December 31, 2025. *See* section 70354(c)(2)(A) of the OBBBA. Any dividend subject to the transition rule is not treated as a dividend for purposes of applying former section 951(a)(2)(B) if the dividend does not increase the taxable income of a United States person subject to Federal income tax for the taxable year (including by reason of a dividends received deduction, an exclusion from gross income, or an exclusion from subpart F income). *See* section 70354(c)(2)(B) of the OBBBA.

On December 4, 2025, the Treasury Department and the IRS released Notice 2025-75, 2025-52 I.R.B. 867 (transition rule notice), describing rules expected to be included in forthcoming proposed regulations regarding the application of the transition rule. The transition rule notice describes rules addressing the meaning of dividends paid or deemed paid by a CFC and the determination of whether a dividend does not increase the taxable income of a United States person subject to Federal income tax.

III. *Other Provisions*

A. *Section 951B*

The OBBBA added section 951B, which generally provides that sections 951 through 965 (other than sections 951A, 951(b), and 957) apply to any foreign controlled United States shareholder (FCUSS) of a foreign controlled foreign corporation (FCFC) by substituting "foreign controlled United States shareholder" for "United States shareholder" each place it appears and by substituting "foreign controlled foreign corporation" for "controlled foreign corporation" each place it appears. *See* section 951B(a)(1). Section 951A applies to an FCUSS by treating each reference to a "United States shareholder" in such section as including a reference to an FCUSS, and by treating each reference to a "controlled foreign corporation" in such section as including a reference to an FCFC. *See* section 951B(a)(2).

Section 951B(b) provides that an FCUSS is any United States person that would be a U.S. shareholder with respect to a foreign corporation if section 951(b) were applied by substituting "more than 50 percent" for "10 percent or more," and section 958(b) were applied without regard to section 958(b)(4). Section 951B(c) provides that an FCFC is a foreign corporation, other than a CFC, which would be a CFC if section 957(a) were applied by substituting "foreign controlled United States shareholders" for "United States shareholders," and section 958(b) were applied without regard to section 958(b)(4).

B. *Section 960*

Section 901(a) generally provides that a taxpayer choosing to credit foreign income taxes is allowed a credit for certain foreign income taxes paid or accrued by the taxpayer plus, in the case of a corporation, the taxes deemed to have been paid by the corporation under section 960.

Section 960(a) provides that, if a domestic corporation that is a U.S. shareholder of a CFC includes any item of income under section 951(a)(1), the domestic corporation is deemed to have paid so much of the CFC's foreign income taxes as are properly attributable to such item of income. Section 960(d) generally provides that if any amount is includible in the gross income of a domestic corporation under section 951A, the domestic corporation is deemed to pay a percentage of the foreign income taxes paid or accrued by its CFCs with respect to their tested income.

C. *Section 245A and §1.245A-5(e) and (f)*

Section 245A(a) allows a domestic corporation that is a U.S. shareholder a 100-percent deduction for the foreign-source portion of a dividend received from a specified 10-percent owned foreign corporation (section 245A deduction). *See also* sections 964(e)(4) and 1248(j) (generally permitting the section 245A deduction in connection with the sale or exchange of stock of a CFC). A specified 10-percent owned foreign corporation (SFC) is defined as any foreign corporation (other than a passive foreign investment company as defined in section 1297) with respect to which a domestic corporation is a U.S. shareholder.

Section 954 generally provides that a dividend received by a CFC is included in the CFC's foreign personal holding company income (as defined in section 954(c)) and, thus, in the determination of the CFC's subpart F income. Under section 954(c)(6), however, a dividend received by a CFC from a related CFC is not included in the CFC's foreign personal holding company income if certain requirements are met (section 954(c)(6) exception).

Under §1.245A-5(e), a section 245A shareholder (defined as a domestic corporation that is a U.S. shareholder with respect to an SFC and that owns directly or indirectly stock of the SFC) is not allowed a section 245A deduction for any dividend received from an SFC to the extent of the extraordinary reduction amount. Additionally, §1.245A-5(f) provides that, if an upper-tier CFC receives a dividend from a lower-tier CFC in the same taxable year that an extraordinary reduction occurs with respect to the lower-tier CFC, then the section 954(c)(6) exception applies only to the extent the dividend exceeds the tiered extraordinary reduction amount.

In general, an extraordinary reduction amount is, with respect to a dividend received by a controlling section 245A shareholder (as defined in §1.245A-5(i)(2)) from a CFC during a taxable year of the CFC in which an extraordinary reduction occurs with respect to the controlling section 245A shareholder's ownership of the CFC, the lesser of (i) the amount of the dividend, and (ii) the amount equal to the sum of the controlling section 245A shareholder's pre-reduction pro rata share of the CFC's subpart F income and tested income for the taxable year, reduced, but not below zero, by the prior extraordinary reduction amount. A pre-reduction pro rata share generally reflects the amount of subpart F income and tested income that the shareholder would have included in income, absent the extraordinary reduction. An extraordinary reduction generally occurs where a controlling section 245A shareholder transfers more than 10 percent of the CFC's stock during the CFC's taxable year or where the shareholder's ownership of the CFC otherwise decreases by more than 10 percent by the end of the taxable year.

An election may be made to close a CFC's taxable year if an extraordinary reduction occurs with respect to a controlling section 245A shareholder and there would be an extraordinary reduction amount or tiered extraordinary reduction amount greater than zero. If the election is made, no amount is considered an extraordinary reduction amount or tiered extraordinary reduction amount with respect to the controlling section 245A shareholder. Instead, the CFC's taxable year closes for all purposes of the Code and for all shareholders of the CFC.

Explanation of Provisions

I. *Scope*

The proposed regulations would provide rules under sections 951 and 951A that determine a U.S. shareholder's pro rata share of a CFC's subpart F income, tested income, or tested loss. The proposed regulations would also modify information reporting regulations under section 6038 and the applicability date of certain regulations under sections 245A and 1502.

II. *Section 951 Regulations*

A. *Overview*

The proposed regulations under section 951 would provide rules to determine a U.S. shareholder's pro rata share of a CFC's subpart F income that reflect the changes to section 951(a) made by the OBBBA. The proposed regulations would also provide rules that require or permit the closing of a foreign corporation's taxable year in certain circumstances for all purposes of the Code.

B. *Income inclusion rule*

The proposed regulations would require each U.S. shareholder of a foreign corporation that owns stock in the foreign corporation at any time during a taxable year of the foreign corporation that is a CFC year to include in gross income the U.S. shareholder's pro rata share of the foreign corporation's subpart F income for the CFC year. *See* proposed §1.951-1(b)(1). This amount is included in gross income in the U.S. shareholder's taxable year that includes the last day on which the shareholder owns stock in the foreign corporation during the CFC year. The determination of the amount of a U.S. shareholder's pro rata share of subpart F income of a CFC for a CFC year is discussed in part II.E of this Explanation of Provisions.

The proposed regulations would also provide a rule for section 956 inclusions under section 951(a)(1)(B). *See* proposed §1.951-1(b)(2). Because the amendments made by the OBBBA to section 951 generally retain the same approach to determining inclusions under section 951(a)(1)(B), this rule is consistent with the regulations under former section 951(a)(1)(B). However, as with inclusions of subpart F income under section 951(a)(1)(A), the proposed regulations would provide that amounts required to be included in gross income under section 951(a)(1)(B) are included in the U.S. shareholder's taxable year that includes the last day on which the shareholder owns stock in the foreign corporation during the CFC year, which may accelerate the taxable year of the inclusion relative to former section 951(a)(1)(B). Further, as discussed in part II.D of this Explanation of Provisions, the closing of a foreign corporation's taxable year under the proposed regulations may affect the calculation of amounts under section 956 and a U.S. shareholder's inclusion under section 951(a)(1)(B).

C. *Changes in ownership of CFC stock*

As revised in the OBBBA, a U.S. shareholder's pro rata share of a CFC's subpart F income (as well as tested income or tested loss) is the amount attributable to the stock of the CFC owned by the U.S. shareholder and the periods of the CFC year during which the U.S. shareholder owned such stock while the foreign corporation was a CFC. The Treasury Department and the IRS considered various recommendations for implementing the OBBBA's revisions to the pro rata share rules. For example, the Treasury Department and the IRS considered a suggestion to address changes in ownership of stock of a CFC by permitting taxpayers to elect a per diem approach with exceptions for extraordinary items or an interim closing of the books approach, and to provide taxpayers an election to close the taxable year of CFCs in certain circumstances comparable to the election permitted under §1.245A-5(e). The Treasury Department and the IRS also considered a suggestion to provide for both elective and mandatory closings with respect to the taxable year of a CFC, depending on the amount of ownership shift in a given transaction, and to otherwise address changes in ownership of stock of a CFC by implementing a ratable approach to determining a U.S. shareholder's pro rata share.

In general, in cases where there is no change in the ownership of stock of a CFC during its taxable year, a U.S. shareholder's pro rata share under the proposed regulations would be the same as determined under the existing rules in §1.951-1(e) (*see* part II.E of this Explanation of Provisions). However, to address changes in ownership of stock of a CFC, and largely consistent with a recommendation received, the proposed regulations would generally apply a daily proration approach to allocating subpart F income, tested income, or tested loss to U.S. shareholders and, in certain cases, would require or permit a closing of the taxable year.

The Treasury Department and the IRS are of the view that other suggested approaches to address changes in ownership of stock of a CFC, such as an interim closing of the foreign corporation's books or a special allocation of extraordinary items, may, in certain cases, be complex, administratively burdensome, or lead to inappropriate results (for example, when the earnings and profits (E&P) limitation under section 952(c) applies). Rules in other contexts that adopt such approaches in allocating various items of income, gain, deduction, loss, and credit attributable to a taxpayer's ownership period differ from the pro rata share rules in that sections 951 and 951A require the allocation of subpart F income, tested income, or tested loss, each of which is a single, net amount determined at the foreign corporation level with respect to its taxable year. *Cf.* §1.706-4 (providing various rules, including a proration approach, interim closing method, and extraordinary item exception, where a partner's interest in a partnership varies during its taxable year) and §1.1502-76(b) (permitting the ratable allocation of a year's items (other than extraordinary items) between the periods ending and beginning with a corporation becoming or ceasing to be a member of a consolidated group). The statutory language in section 951(a)(1)

(A) requires this result by referring to the pro rata share of "the corporation's subpart F income for the CFC year," which, in using the term defined in section 952, means the pro rata share of the sum of the amounts described in section 952(a) and not the pro rata share of specific items that comprise subpart F income. *See also* section 951A(c)(1) (providing that a U.S. shareholder's pro rata share of a CFC's tested income or tested loss, each defined in section 951A(b)(2) as a net amount for the CFC's taxable year, is determined under the rules of section 951(a)(2) in the same manner as such section applies to subpart F income).

The proposed regulations would require a closing of a foreign corporation's taxable year only in circumstances where the change in ownership of stock of a foreign corporation results in the foreign corporation becoming or ceasing to be a CFC (subject to certain modifications for determining CFC status that generally are intended to prevent avoidance of the rule). *See* part II.D.2 of this Explanation of Provisions. In those cases, the provision's requirement to determine the subpart F income, tested income, or tested loss attributable to the ownership period of a U.S. shareholder is appropriately carried out by confining the analysis to the period in which the relevant earnings of the foreign corporation are subject to U.S. taxation under sections 951 through 965. The closing of the foreign corporation's taxable year in such cases prevents items of income, gain, deduction, or loss incurred while the foreign corporation's earnings are not subject to the subpart F provisions of the Code from affecting the determination of a U.S. shareholder's pro rata share under section 951 or 951A. Additionally, the required closing of the foreign corporation's taxable year may mitigate potential compliance burdens associated with obtaining information relating to the foreign corporation while it is owned and controlled by foreign persons.

In other cases involving changes in the ownership of stock of a foreign corporation during a CFC year, the proposed regulations would generally apply a daily proration approach. *See* part II.E of this Explanation of Provisions. The Treasury Department and the IRS are of the view that this approach, which allocates subpart F income (as well as tested income or tested loss) proportionately based on the number of days in the CFC year, is consistent with the statute's requirement to attribute an overall income amount to periods of ownership. *See also* §§1.1248-2 and 1.1248-3 (applying a similar daily proration approach for purposes of determining E&P attributable to foreign corporation stock owned by a United States person during certain periods). However, for certain changes in the ownership of stock of a CFC involving unrelated persons that generally result in shifts of ownership of more than 50 percentage points, the proposed regulations would provide an election to close the CFC's taxable year. This election permits taxpayers to achieve the accuracy, certainty, and reduced compliance burdens afforded by closing the taxable year in lieu of applying the daily proration approach to the entire taxable year. *See* part II.D.3 of this Explanation of Provisions. Contrary to certain recommendations that an elective closing be available upon less substantial transfers of ownership, the proposed regulations would limit elective closings to these circumstances, as a greater than 50 percentage point shift in ownership generally indicates that a seller or selling group has relinquished control of the CFC and therefore has a heightened interest in closing the CFC's taxable year so as to avoid the effect of the new controlling shareholder or shareholders' actions on the determination of their pro rata share. In these cases, the seller typically does not remain involved in the CFC's activities after relinquishing control, and an inability to close the taxable year could require the buyer and seller to coordinate in terms of tax compliance and controversy defense with respect to that year, potentially necessitating complex contractual provisions. Further, the potential benefit afforded by a closing of the CFC's taxable year in cases of less significant changes in ownership would likely be outweighed by the resulting compliance and administrative burden, and the additional flexibility to close the taxable year of a CFC could lead to improper manipulation or abuse if it was available for minor changes in ownership or transfers involving related persons.

D. *Determination of CFC year*

1. In General

A U.S. shareholder's pro rata share of a foreign corporation's subpart F income is determined by reference to a CFC year of the foreign corporation. The determination of a CFC year of a foreign corporation is made after the application of rules in the proposed regulations that would require or permit the closing of the taxable year of a foreign corporation in certain cases where there is a change in the ownership of stock of the foreign corporation.

2. Mandatory Closing of Taxable Year of Foreign Corporation

The proposed regulations would provide that a foreign corporation closes its taxable year if there is a status change event, which occurs if a foreign corporation becomes or ceases to be a CFC. *See* proposed §1.951-1(d)(1). If there is a status change event, the taxable year of the foreign corporation closes for all purposes of the Code and, thus, the closing applies to all shareholders of the foreign corporation regardless of whether a particular shareholder's ownership of stock in the foreign corporation changes.

The taxable year of the foreign corporation closes as of the end of the day on which the status change event occurs, which is the last day that the foreign corporation is or is not a CFC (unless the taxable year otherwise closes as of such date under another provision of the Code, for example, as a result of a section 338(g) election). *See* proposed §1.951-1(d)(1)(ii). Thus, for example, if a domestic corporation owns all the stock of a foreign corporation (which uses a calendar taxable year) and sells all the stock of the foreign corporation to a nonresident alien individual on June 30, the status change event would occur on June 30, the date the foreign corporation ceases to be a CFC, and the taxable yefar of the foreign corporation would close as of the end of the day on June 30. *See also* proposed §1.951-1(f) (regarding the ownership period of foreign corporation stock) discussed in part II.F of this Explanation of Provisions.

The proposed regulations would provide additional rules for domestic partnerships (including certain S corporations treated as partnerships by operation of section 1373(a)) and options to acquire stock in determining whether there is a status change event that requires the closing of a foreign corporation's taxable year. *See* proposed §1.951-1(d)(1)(iii). Specifically, solely for this purpose, in determining whether a foreign corporation is a CFC when stock of a foreign corporation is owned through a domestic partnership, the rule in §1.958-1(d)(1) would apply without regard to the exceptions in §1.958-1(d)(2)(i) and (ii) (and, thus, a domestic partnership would not be treated as owning stock of a foreign corporation within the meaning of section 958(a)). A similar rule would disregard the constructive ownership of stock of a foreign corporation by reason of an option to acquire such stock under section 318(a)(4) and §1.958-2(e). These rules are generally intended to ensure that, while the requirement to close the taxable year of a foreign corporation is based on the CFC status of the foreign corporation, the CFC status of the foreign corporation for this purpose is determined by reference to the U.S. shareholders of the foreign corporation that are subject to income inclusions under sections 951 and 951A. Thus, for example, if a domestic corporation sells all the stock of a foreign corporation that is a CFC to a domestic partnership, and not more than 50 percent of the stock of the foreign corporation is owned after the sale, in the aggregate, by partners of the domestic partnership that are U.S. shareholders in the foreign corporation, the sale results in a status change event of the foreign corporation because, for this purpose, the foreign corporation ceases to be a CFC. Similarly, if a domestic partnership sells all the stock of a foreign corporation to a domestic corporation, and not more than 50 percent of the stock of the foreign corporation was owned before the sale, in the aggregate, by partners of the domestic partnership that were U.S. shareholders in the foreign corporation, the sale also results in a status change event because, for this purpose, the foreign corporation *becomes* a CFC.

3. Election to Close Taxable Year of Foreign Corporation

Under the proposed regulations, the controlling section 958(a) U.S. shareholders of a CFC may elect to close the CFC's taxable year if a significant ownership variance occurs with respect to the CFC and the taxable year does not otherwise close on that date. *See* proposed §1.951-1(d)(2). As with the mandatory closing of a foreign corporation's taxable year described in part II.D.2 of this Explanation of Provisions, if the election is made, the taxable year of the CFC closes for all shareholders of the foreign corporation and for all purposes of the Code as of the end of the day on which the significant ownership variance occurs.

The determination of whether there is a significant ownership variance is based on the total change in ownership of CFC stock by section 958(a) U.S. shareholders resulting from all specified transfers that occur pursuant to the same plan during what would be the taxable year of a CFC absent an elective closing (default taxable year). A significant ownership variance generally occurs if the specified transfers result in a decrease by more than 50 percentage points in section 958(a) shareholder ownership. *See* proposed §1.951-1(d)(2)(ii)(A). For this purpose, a specified transfer generally includes a change in the ownership of the stock of a CFC resulting from a sale, exchange, or other disposition of stock of a foreign corporation or a partnership interest, as well as an issuance of stock or a partnership interest.

Because a significant ownership variance looks to all specified transfers that occur pursuant to the same plan during the same default taxable year of a CFC, the proposed regulations are intended to make the election available for transactions undertaken by multiple section 958(a) U.S. shareholders or that involve multiple specified transfers over the course of the CFC's default taxable year. For example, the proposed regulations would permit an elective closing of a CFC's taxable year if multiple section 958(a) U.S. shareholders that separately do not own more than 50 percent of the stock of a CFC together sell more than 50 percent of the stock of the CFC pursuant to the same plan on different days during the CFC's default taxable year.

If there are multiple specified transfers that occur pursuant to the same plan on different days in a default taxable year of a CFC, the significant ownership variance occurs on the day that the last such specified transfer occurs. *See* proposed §1.951-1(d)(2)(ii)(A). This is the case regardless of the day on which there has been a more than 50-percent decrease in the ownership percentage of one or more section 958(a) U.S. shareholders of the CFC. For example, assume US1 and US2, both domestic corporations, own 60 percent and 40 percent of the stock of CFC, respectively. CFC uses a calendar taxable year. On June 30, US1 sells all its stock of CFC (60 percent) to US3, also a domestic corporation that is not related to US1 or US2, and pursuant to the same plan, US2 sells all its stock in CFC (40 percent) to US3 on September 1. In that case, the significant ownership variance occurs on September 1, the date of US2's sale, and, if an election is made, the taxable year of CFC closes on that date.

The Treasury Department and the IRS are of the view that the elective closing of the taxable year of a CFC should be restricted with respect to specified transfers among related parties because, in those cases, the change in economic ownership of CFC stock is less meaningful or possibly absent. Likewise, there is less reason, from an accuracy and burden-reduction standpoint, to provide an elective closing in the case of a transfer between related persons, and the availability of the election may lead to inappropriate manipulation (for example, transactions may be undertaken solely for purposes of closing a CFC's taxable year). Accordingly, the proposed regulations would generally provide that, in determining whether there is a significant ownership variance with respect to a CFC, the percentage of ownership of stock of the CFC owned by section 958(a) U.S. shareholders is not treated as decreasing to the extent there is an increase in the percentage of ownership of stock of the CFC by a related United States person. *See* proposed §1.951-1(d)(2)(ii)(C)(*1*). For similar reasons, the proposed regulations would not take into account certain transfers in connection with reorganizations described in section 368(a)(1)(F) for this purpose. *See* proposed §1.951-1(d)(2)(ii)(C)(*2*).

The section 958(a) U.S. shareholders of a CFC are the U.S. shareholders that own stock of the CFC. For purposes of making the election to close a CFC's taxable year, the controlling section 958(a) U.S. shareholders are all the section 958(a) U.S. shareholders of a CFC whose ownership of stock of the CFC decreases in a significant ownership variance. In certain cases, there may be only one controlling section 958(a) U.S. shareholder that makes the election (for example, if a U.S. shareholder owns all the stock of a CFC). A domestic partnership is not treated as owning stock of a CFC for this purpose and therefore cannot be a section 958(a) U.S. shareholder or a controlling section 958(a) U.S. shareholder. *See* §1.958-1(d).

To make the election, the controlling section 958(a) U.S. shareholders and each U.S. shareholder (if any) of the CFC that owns stock of the CFC on any date during the CFC's taxable year on or before the date of the significant ownership variance must enter into a written, binding agreement that all parties agree to the election. Each party to this binding agreement must be able to present the agreement to the IRS for inspection upon request. No binding agreement is required, however, if there is only one controlling section 958(a) U.S. shareholder and no other relevant U.S. shareholders of the CFC. Additionally, for this purpose, a U.S. shareholder that acquires stock of the CFC on the date of the significant ownership variance is not considered as owning that stock on that date and therefore is not required to enter the binding agreement unless the shareholder otherwise was a U.S. shareholder on or before that date. *See* proposed §1.951-1(f). The proposed regulations would prescribe additional procedural requirements for making the election, including the requirement to provide certain information in a statement that must be submitted to the IRS. *See* proposed §1.951-1(d)(2)(iv). The proposed regulations would also provide a consistency requirement, under which, if a significant ownership variance occurs with respect to multiple CFCs pursuant to a plan or series of related transactions, an election to close a CFC's taxable year may be made only if the election is made with respect to all the CFCs. *See* proposed §1.951-1(d)(2)(vi).

4. Allocation of Foreign Income Taxes

The proposed regulations would provide a rule for allocating certain foreign income taxes that accrue during the period that would have been the foreign corporation's taxable year if not for the mandatory or elective closing. A mandatory or elective closing of a foreign corporation's taxable year can result in the foreign corporation's foreign taxable year spanning multiple short U.S. taxable years. However, the foreign income tax with respect to that foreign taxable year would accrue only in the U.S. taxable year in which the foreign taxable year ends. *See* §1.905-1(d)(1)(i). The proposed regulations would address this issue by requiring an allocation of a portion of the foreign income tax that accrues in the CFC's U.S. taxable year following the closing date to the U.S. taxable year ending with the closing. *See* proposed §1.951-1(d)(3)(i). The portion of the foreign income tax allocated to the U.S. taxable year ending with the closing is determined based on the portion of the foreign taxable income attributable to the period of the foreign taxable year ending with the closing using the closing of the books method described in §1.1502-76(b). For example, if a foreign corporation that uses a calendar taxable year for both U.S. and foreign income tax purposes has its U.S. taxable year close on June 30 as a result of a mandatory or elective closing and the foreign corporation earned 50 percent of its foreign taxable income from January to June 30, 50 percent of the foreign income tax that accrues on December 31 (at the end of the foreign corporation's foreign taxable year and during its U.S. taxable year following the June 30 closing) would be allocated to its U.S. taxable year ending with the closing (January 1 to June 30).

5. Taxable Years of Partnerships Owned by Foreign Corporations

In the case of a foreign corporation that owns an interest in a partnership, generally, the partnership's taxable year would not close for any purpose of the Code solely as a result of the foreign corporation's taxable year closing. Therefore, if the partnership's taxable year begins before a status change event or significant ownership variance (for which an election is made) and ends after the early closing of the foreign corporation's taxable year, the foreign corporation would include its distributive share of the partnership's items arising in that partnership taxable year entirely in the foreign corporation's short taxable year following the status change event or significant ownership variance. By contrast, a concurrent closing of the partnership's taxable year would require the partnership's items to be allocated between the foreign corporation's short taxable year ending on the day of the status change event or significant ownership variance and the following short taxable year. Because this requirement to allocate partnership items between periods that are pre- and post-sale of stock of the foreign corporation would require a seller to obtain information from a buyer to determine the foreign corporation's distributive share of partnership items includible in the foreign corporation's first short taxable year, the proposed regulations would not provide for a closing of the partnership's taxable year with respect to the foreign corporation.

The Treasury Department and the IRS welcome comments as to whether a closing of a foreign corporation's taxable year as a result of a status change event or significant ownership variance should be treated as a deemed disposition of the foreign corporation's entire interest in a partnership for purposes of section 706, and therefore result in a closing of the partnership's taxable year with respect to the foreign corporation partner. *Cf.* §§1.706-1(c)(2)(i) and (iii), 1.1362-3(c)(1), 1.1377-1(b)(3)(iv), and 1.1502-76(b)(2)(vi) (in certain cases, treating an early closing of a corporate partner's taxable year as a deemed disposition of the partner's entire interest in the partnership and therefore resulting in treating the partnership taxable year as closing with respect to that partner).

E. *Determination of pro rata share of subpart F income*

1. In General

The proposed regulations would provide rules for determining a U.S. shareholder's pro rata share of a CFC's subpart F income for a CFC year. This determination is made after the determination of the subpart F income of the CFC for the CFC year in accordance with section 952 and other applicable provisions, such as the E&P limitation, the chain deficit rules, and the recapture rules.

In general, the proposed regulations would apply a daily proration approach for purposes of determining the amount of a CFC's subpart F income that is attributed to the period during which a U.S. shareholder owns stock of a foreign corporation while it is a CFC during the CFC year. *See* part II.E.2 of this Explanation of Provisions. The proposed regulations would provide additional rules for applying this daily proration approach in circumstances involving multiple classes of stock of a foreign corporation and changes in the number of shares of outstanding stock of a foreign corporation during the CFC year. *See* parts II.E.3 and 4 of this Explanation of Provisions.

2. Single Class of Foreign Corporation Stock

Under the proposed regulations, if at all times during the CFC year the CFC has only a single class of stock outstanding and there is no change in the number of outstanding shares of stock of the CFC, a U.S. shareholder's pro rata share of subpart F income of a CFC would be determined based on the percentage of stock of the CFC the U.S. shareholder owned (that is, the number of shares the U.S. shareholder owned over the number of outstanding shares of the CFC) and the percentage of the CFC year during which the shareholder owned the stock of the foreign corporation while it was a U.S. shareholder and the foreign corporation was a CFC. *See* proposed §1.951-1(e)(2)(i).

Thus, for example, if two U.S. shareholders (US1 and US2) each owned 50 percent of the single class of stock of a CFC for an entire CFC year, each of US1's and US2's pro rata shares of the CFC's subpart F income for the CFC year is equal to the proportionate amount of subpart F income attributable to the stock of the CFC the U.S. shareholder owned (that is, 50 percent of CFC's subpart F income). As an additional example, if US1 instead transfers all of its stock of a CFC to another U.S. shareholder (US3) during the CFC year, each of US1 and US3's pro rata share of the CFC's subpart F income for the CFC year is equal to the proportionate amount of subpart F income attributable to the stock multiplied by the percentage of days during the CFC year on which the U.S. shareholder owned the stock of the CFC. *See* proposed §1.951-1(e)(4)(iii) (Example 2).

The computation prescribed in the proposed regulations is made separately with respect to CFC year blocks, which are those shares of a class of stock of the CFC that a U.S. shareholder owned for the same period within the CFC year (for example, if the U.S. shareholder acquired or disposed of a portion of its shares of the class of stock of the CFC during the CFC year). *See* proposed §1.951-1(e)(2)(i)(B). A U.S. shareholder's pro rata share of subpart F income of the CFC for the CFC year is equal to the total of the amounts determined for each of its CFC year blocks. *See* proposed §1.951-1(e)(4)(iii) (Example 2).

3. Multiple Classes of Foreign Corporation Stock

The proposed regulations would provide additional rules to address cases in which a foreign corporation has multiple classes of stock outstanding during a CFC year. In general, the proposed regulations would adopt the hypothetical distribution analysis under existing §1.951-1(e) for purposes of determining the subpart F income that is allocated among the classes of stock of a foreign corporation. Thus, to determine a U.S. shareholder's pro rata share of a CFC's subpart F income for a CFC year, the subpart F income is first allocated to the classes of stock of the CFC in the same proportion as the amount of allocable earnings and profits that would be distributed to each class of stock in a hypothetical distribution of the CFC's allocable earnings and profits on the last day of the CFC year (hypothetical distribution). *See* proposed §1.951-1(e)(2)(ii). After the subpart F income is allocated to a class of stock, a U.S. shareholder determines its pro rata share of subpart F income with respect to each class of stock using the daily proration approach described in part II.E.2 of this Explanation of Provisions. *See* proposed §1.951-1(e)(4)(iv) (Example 3).

For example, if, for the entirety of a CFC year, one U.S. shareholder (US1) owned all the common stock of a CFC and another U.S. shareholder (US2) owned all the preferred stock of the CFC, the hypothetical distribution applies to allocate the subpart F income of the CFC to the preferred and common stock. Each of US1 and US2's pro rata share of the CFC's subpart F income for the CFC year is then equal to the proportionate amount of subpart F income allocated to each class of stock of the foreign corporation that is attributable to the stock of the CFC the U.S. shareholder owned (thus, US1's pro rata share is equal to all of the subpart F income allocated to the common stock and US2's pro rata share is equal to all of the subpart F income allocated to the preferred stock). As an additional example, if US2 instead transfers all of its stock of the CFC (that is, the preferred stock) to another U.S. shareholder (US3) during the CFC year, each of US2 and US3's pro rata share of the CFC's subpart F income for the CFC year is equal to the subpart F income allocated to the preferred stock of the CFC as determined under the hypothetical distribution, multiplied by the percentage of days during the CFC year on which the U.S. shareholder owned the preferred stock of the CFC. *See* proposed §1.951-1(e)(4)(iv) (Example 3).

4. Changes in Number of Outstanding Shares of Foreign Corporation

The proposed regulations would provide additional rules to address cases in which there are changes in the number of shares of stock of a foreign corporation outstanding during the year, for example, as a result of a redemption or issuance of stock of the foreign corporation during a CFC year. In general, the proposed regulations would adopt an approach based on the average number of shares outstanding of the foreign corporation during the CFC year. *See also* §1.1248-3(c)(2) (applying a similar share averaging approach for purposes of determining E&P attributable to stock of a foreign corporation).

If the number of shares outstanding within a class of stock of a CFC varies during the CFC year, the proposed regulations would provide that the daily proration approach described in part II.E.2 of this Explanation of Provisions is applied with respect to a class of stock by substituting a weighted average share count for the number of the CFC's shares outstanding during the CFC year when determining the U.S. shareholder's percentage of ownership of the stock of the foreign corporation. *See* proposed §1.951-1(e)(2)(iii)(A). The weighted average share count is equal to the sum of the number of shares outstanding on each day of the CFC year divided by the number of days in the CFC year. *See* proposed §1.951-1(e)(4)(v) (Example 4).

If there is more than one class of stock of a CFC outstanding during the CFC year and the number of shares within a class of stock varies during the CFC year, then the hypothetical distribution described in part II.E.3 of this Explanation of Provisions is based on the allocable earnings and profits that would be distributed to a class of shares if a weighted average share count was outstanding on the last day of the CFC year. *See* proposed §1.951-1(e)(2)(iii)(B) and (4)(v) (Example 4).

F. *Ownership period of foreign corporation stock*

Section 1.951-1(f) provides that, for purposes of sections 951 through 964, the holding period of an asset (including stock of a CFC) is determined by excluding the day on which such asset is acquired and including the day on which such asset is disposed of. The proposed regulations would clarify that this rule applies in determining the period when stock of a foreign corporation is owned. Thus, for example, if a U.S. shareholder sells all the stock of a CFC to another U.S. shareholder, the selling U.S. shareholder is treated as owning the stock of the CFC through the end of the day of the sale, and the acquiring U.S. shareholder is treated as owning the stock of the CFC as of the beginning of the day immediately after the sale.

III. *Section 951A Regulations*

A. *Pro rata share of tested income or tested loss*

The proposed regulations would revise §1.951A-1 to coordinate the determination of a U.S. shareholder's pro rata share of a CFC's tested income or tested loss with the rules provided in proposed §1.951-1, including the determination of a foreign corporation's CFC year under the rules for mandatory and elective closings of a foreign corporation's taxable year. *See* proposed §1.951A-1(d). The proposed regulations would generally retain the rules relating to the allocation of tested loss to preferred stock but modify those provisions to apply for purposes of the hypothetical distribution described in proposed §1.951-1(e)(2)(ii). *See* proposed §1.951A-1(d)(2)(ii) and (3). The examples under §1.951A-1 would also be modified to illustrate the pro rata share rules in the proposed regulations. *See* proposed §1.951A-1(d)(2)(iii) and (3)(iv).

B. *Section 951A inclusion rules*

The proposed regulations would revise §1.951A-1 to incorporate other amendments to section 951A in the OBBBA. In particular, the proposed regulations would provide that, under section 951A as revised by the OBBBA, a U.S. shareholder is required to include in gross income its net CFC tested income inclusion amount, and the proposed regulations would prescribe the rule for determining this amount. *See* proposed §1.951A-1(b) and (c). The proposed regulations would also remove the rules for determining a U.S. shareholder's pro rata share of qualified business asset investment, tested interest expense, and tested interest income. The Treasury Department and the IRS anticipate proposing additional changes to the regulations under section 951A to conform with the amendments made in the OBBBA in a separate guidance project.

IV. *Information Reporting under Section 1.6038-2*

Section 6038(a)(1) provides that every United States person that controls (within the meaning of section 6038(e)(2)) any foreign business entity must furnish with respect to that entity such information as the Secretary may prescribe related to the items listed in section 6038(a)(1)(A) through (E) and any other information that is similar or related in nature to such listed information or which the Secretary determines to be appropriate to carry out the provisions of the Code. Section 1.6038-2(f) sets forth information that may be required to be provided on Form 5471.

The proposed regulations would modify the information described in §1.6038-2(f)(8) regarding the outstanding stock of a foreign corporation to reflect the amendments made by the OBBBA to sections 951 and 951A. *See* proposed §1.6038-2(f)(8). Additionally, as revised, proposed §1.6038-2(f) would provide that returns on Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*, must contain information prescribed by Form 5471 (or successor form) and that such information may include, but is not limited to, the information set forth in §1.6038-2(f). This revision clarifies that additional information may be required on Form 5471 that is not described by regulation, consistent with section 6038(a)(1).

V. *Related Provisions*

A. *Section 951B*

As described in part III.A of the Background, pursuant to section 951B(a)(1), section 951 applies to FCUSSs and FCFCs by replacing references to "United States shareholder" with "foreign controlled United States shareholder" and references to "controlled foreign corporation" with "foreign controlled foreign corporation." Additionally, under section 951B(a)(2), section 951A applies to an FCUSS by treating references to a "United States shareholder" as including a reference to an FCUSS and by treating each reference to a "controlled foreign corporation" as including a reference to an FCFC.

Pursuant to the application of section 951B, the proposed regulations under sections 951 and 951A would apply to FCUSSs and FCFCs in the same manner. Thus, the proposed regulations under section 951 would apply by substituting references to "United States shareholder" for "foreign controlled United States shareholder" and references to "controlled foreign corporation" for "foreign controlled foreign corporation." The proposed regulations under section 951A would apply by treating each reference to a "United States shareholder" as including a reference to an FCUSS and by treating each reference to a "controlled foreign corporation" as including a reference to an FCFC.

Because the proposed regulations would apply the same rules under sections 951 and 951A to FCUSSs and FCFCs pursuant to section 951B, the election to close the taxable year of a foreign corporation under proposed §1.951-1(d)(2) would not be available to FCUSSs with respect to an FCFC because such shareholders cannot own the requisite percentage of stock of an FCFC (more than 50 percent of the vote or value) for a significant ownership variance to occur. The mandatory closing of a foreign corporation's taxable year under proposed §1.951-1(d)(2), however, is required if a foreign corporation becomes or ceases to be an FCFC for the same reasons described in part II.C of this Explanation of Provisions. The mandatory closing of a foreign corporation's taxable year would include cases in which a CFC becomes an FCFC or an FCFC becomes a CFC to ensure the proper operation of section 951B.

B. *Section 960*

These proposed regulations would not make any changes to the regulations under section 960. While the determination of a corporate U.S. shareholder's pro rata share of a CFC's subpart F income, tested income, or tested loss has changed, the regulations under section 960 should continue to operate appropriately to determine the foreign income taxes deemed paid by a domestic corporation as a result of its inclusions under sections 951(a)(1) and 951A.

VI. *Effect on Other Regulations*

A. *Section 1.1502-80(j)*

Section 1.1502-80(j) provides that, in determining the amount described in former section 951(a)(2)(B) that is attributable to distributions of previously taxed earnings and profits to which section 959(b) applies, members of a consolidated group (as defined in §1.1502-1(h)) are treated as a single U.S. shareholder for purposes of determining the part of the year during which such shareholder did not own the stock described in former section 951(a)(2)(A). Following the revisions to section 951 in the OBBBA, for taxable years of foreign corporations that begin after December 31, 2025, former section 951(a)(2)(B) does not apply in determining a U.S. shareholder's pro rata share of subpart F income or tested income. As a result, to the extent former section 951(a)(2)(B) is no longer relevant, §1.1502-80(j) is no longer necessary to address the application of former section 951(a)(2)(B) within a consolidated group with respect to distributions to which section 959(b) applies. Accordingly, the proposed regulations would amend the applicability date in §1.1502-80(j)(3) to clarify that §1.1502-80(j) applies only to the extent former section 951(a)(2)(B) is applicable.

B. *Section 1.245A-5(e) and (f)*

The Treasury Department and the IRS are of the view that, because of the revisions to sections 951 and 951A in the OBBBA, the extraordinary reduction rules in §1.245A-5(e) and (f) are no longer necessary. Accordingly, under the proposed regulations, the extraordinary reduction rules would not apply for taxable years of foreign corporations beginning after December 31, 2025. *See* proposed §1.245A-5(k)(3). The proposed regulations would also modify §1.245A-5(d) (limitation on the section 954(c)(6) exception with respect to extraordinary disposition accounts for lower-tier CFCs) to reflect the revisions to section 951 in the OBBBA. *See* proposed §1.245A-5(d)(1)(ii).

C. *Section 1248 regulations*

In general, under section 1248(a), if a United States person that satisfies certain ownership requirements recognizes gain on a sale or exchange of stock in a foreign corporation, then the gain is included in the gross income of such person as a dividend to the extent of the E&P of the foreign corporation attributable to the stock that accumulated while the United States person held the stock and the corporation was a CFC, taking into account E&P of certain lower-tier foreign corporations but excluding previously taxed earnings and profits. For this purpose, regulations under section 1248 provide rules for determining E&P attributable to stock in a foreign corporation in simple and complex cases. *See* §§1.1248-2 and 1.1248-3. The rules addressing complex cases incorporate the principles of §1.951-1(e)(2) and (3) for purposes of allocating E&P to multiple classes of stock of a foreign corporation. *See* §1.1248-3(c)(4) and (d)(6).

The determination of a U.S. shareholder's pro rata share of a CFC's subpart F income, tested income, or tested loss under the proposed regulations is intended to be consistent with the manner in which E&P is attributed to stock of a foreign corporation under the rules prescribed in regulations under section 1248. The Treasury Department and the IRS, however, are studying the regulations under section 1248 and revisions to those regulations may be proposed in a separate guidance project. Comments are requested on the extent to which revisions to the regulations under section 1248 are necessary to coordinate with the proposed regulations under sections 951 and 951A.

D. *Proposed regulations on previously taxed earnings and profits*

On December 2, 2024, the Treasury Department and the IRS published proposed regulations under sections 959 and 961 and certain other provisions of the Code regarding previously taxed earnings and profits (89 FR 95362) (2024 proposed PTEP regulations). The 2024 proposed PTEP regulations contain certain rules premised on former section 951 and also proposed revisions to the regulations under section 951. The Treasury Department and the IRS intend to modify the 2024 proposed PTEP regulations to reflect the amendments to sections 951 and 951A in the OBBBA and the rules in these proposed regulations in a separate guidance project.

VII. *Transition Rule*

A. *Application*

The proposed regulations would provide rules for the application of the transition rule that are consistent with the rules described in the transition rule notice. *See* proposed §1.951-4.

For example, the proposed regulations would provide as a general rule that certain dividends are not treated as dividends for purposes of applying former section 951(a)(2)(B) to the extent the dividend does not increase the taxable income of a United States person subject to Federal income tax. *See* proposed §1.951-4(b). As described in section 3.04 of the transition rule notice, this general rule would apply by reference to the specific shares of stock of the CFC with respect to which a dividend was paid or deemed paid, and for which a U.S. shareholder would otherwise reduce its pro rata share under former section 951(a)(2)(B) absent the application of the transition rule. Accordingly, if a U.S. shareholder acquires shares of stock in a CFC after June 28, 2025, dividends paid with respect to those shares on or before June 28, 2025, and during the taxable year of the CFC that includes such date, are subject to the transition rule even if the U.S. shareholder owned other shares in the CFC on or before June 28, 2025.

The proposed regulations would also define dividends paid or deemed paid, United States person subject to Federal income tax, and taxable income for purposes of the transition rule. *See* proposed §1.951-4(c) through (e).

In addition, the proposed regulations would provide rules for determining whether a dividend increases taxable income. *See* proposed §1.951-4(f). The proposed regulations would provide that all applicable provisions of the Code, and the regulations thereunder, are applied before applying, and without regard to, the transition rule. Therefore, for example, to the extent a dividend paid to a controlling domestic shareholder before an extraordinary reduction would be ineligible for the dividends received deduction under section 245A(a) after applying section 245A and §1.245A-5 without regard to the transition rule, the dividend would be treated as increasing the taxable income of a United States person subject to Federal income tax. The proposed regulations would provide an example demonstrating this result and the consequences that would follow under section 245A.

Finally, the proposed regulations would include the rules on partnerships and S corporations generally described in the transition rule notice, including a safe harbor in the context of certain publicly held partnerships. *See* proposed §1.951-4(g).

B. *Substantiation requirement*

Under section 3.03(4) of the transition rule notice, a U.S. shareholder that reduces its pro rata share of subpart F income or tested income under former section 951(a)(2)(B) as a result of a dividend subject to the transition rule must determine and document that the dividend increased the taxable income of a United States person subject to Federal income tax. The U.S. shareholder is required to provide a statement to the IRS that describes why the U.S. shareholder is entitled to treat such amount as a dividend for purposes of former section 951(a)(2)(B) and how the U.S. shareholder determined such amount increased the taxable income of a United States person subject to Federal income tax.

A commenter on the transition rule notice asserted that the requirement that a U.S. shareholder must determine and document that the dividend increased the taxable income of a United States person subject to Federal income tax is ambiguous and potentially onerous. The commenter noted that the transition rule notice does not explain what level of analysis, substantiation, or third-party information is required to demonstrate that a dividend resulted in an increase to taxable income and indicated that this information would be difficult to obtain for transactions that have already closed. The commenter recommended that the Treasury Department and the IRS eliminate or significantly pare back the requirement where the dividend is required by law to be included in the gross income of a United States person and where no exclusion or deduction could reasonably apply. Alternatively, the commenter suggested adopting a per se rule or safe harbor under which the requirement does not apply to dividends received by certain United States persons for whom inclusion in taxable income is mandatory under the Code and, for all other situations, provide that Federal income tax principles must be analyzed and indicate the type of documentation that is sufficient to demonstrate that the dividend increased taxable income.

The Treasury Department and the IRS are of the view that the substantiation requirement described in the transition rule notice properly requires taxpayers to establish that they are correctly calculating their pro rata share of subpart F income or tested income when applying the transition rule, while adequately prescribing the degree of detail taxpayers must provide. The Treasury Department and the IRS are also of the view that a per se rule or safe harbor rule is not appropriate. For example, in the case of a dividend paid or deemed paid to a United States person for whom inclusion in taxable income is mandatory under the Code (for example, an individual who is a United States citizen), information supporting the determination that the dividend recipient is such a person would satisfy the substantiation requirement. Additionally, a specific description of the types of documentation that taxpayers must provide for substantiation purposes would be overly restrictive. Accordingly, the proposed regulations do not adopt the commenter's recommendations and would include the substantiation requirement described in the transition rule notice. *See* proposed §1.951-4(h).

VIII. *Applicability Dates*

The Treasury Department and the IRS expect to finalize the proposed regulations by January 4, 2027. Under section 7805(b)(2), the proposed regulations under sections 951, 951A, and 6038 are generally proposed to apply to taxable years of foreign corporations beginning after December 31, 2025, and to taxable years of U.S. shareholders for which such taxable years of those foreign corporations are relevant. *See* proposed §§1.951-1(i)(1), 1.951A-7(a), and 1.6038-2(m).

Under section 70354(c) of the OBBBA, the amendments to the pro rata share rules of section 951(a) made by section 70354(a) of the OBBBA are made effective "for taxable years of foreign corporations beginning after December 31, 2025." However, under section 70323(c) of the OBBBA, the amendments to section 951A made by section 70323(a) of the OBBBA, requiring a U.S. shareholder to include in gross income its net CFC tested income instead of its GILTI inclusion amount, are made effective "for taxable years beginning after December 31, 2025," which the Treasury Department and the IRS believe is best interpreted as referring to the taxable years of a U.S. shareholder. Therefore, in the case of a foreign corporation whose taxable year begins after December 31, 2025, but ends with or within a taxable year of a U.S. shareholder that begins on or before December 31, 2025, former section 951A applies with respect to the U.S. shareholder, with the U.S. shareholder's pro rata shares of the CFC's tested items determined under section 951(a)(2) as amended by the OBBBA. Proposed §1.951A-7(c) would therefore provide that, in this fact pattern, the U.S. shareholder applies the former version of §1.951A-1 (which provides for the calculation and inclusion of the U.S. shareholder's GILTI inclusion amount rather than net CFC tested income) with respect to the CFC, but must take into account the amendments to section 951(a)(2) made by the OBBBA in determining the U.S. shareholder's pro rata share of any tested item.

As revised in the proposed regulations, §§1.245A-5(e) and (f) and 1.1502-80(j) would not apply with respect to taxable years of foreign corporations beginning after December 31, 2025. *See* proposed §§1.245A-5(k)(3) and 1.1502-80(j)(3).

Under section 7805(b)(2), the proposed regulations regarding the transition rule would apply to taxable years of a foreign corporation that either include June 28, 2025, or begin after June 28, 2025, but before the foreign corporation's first taxable year beginning after December 31, 2025. *See* proposed §1.951-4(i).

Taxpayers may rely on all aspects of the proposed regulations before the date the proposed regulations are finalized, provided a taxpayer and its related parties (within the meaning of sections 267(b) and 707(b)(1)) follow the rules in their entirety and in a consistent manner.

Special Analyses

I. *Regulatory Planning and Review — Economic Analysis*

The Office of Management and Budget's (OMB) Office of Information and Regulatory Analysis has determined that this proposed regulation is not significant and is not subject to review under section 6(b) of Executive Order 12866. 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) generally 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. 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 OMB.

The collections of information in these proposed regulations contain reporting and recordkeeping requirements that enable the IRS to verify that a taxpayer is reporting the correct amount of taxable income. The collections of information will be used by the IRS for tax compliance purposes. The likely respondents are individuals, businesses, and other for-profit institutions.

The collections of information in the proposed regulations are in proposed §§1.951-1(d)(2)(i) and (iv), 1.951-4(h), and 1.6038-2(f)(8).

The collections of information in proposed §1.951-1(d)(2)(i) and (iv) are elective for controlling section 958(a) U.S. shareholders electing to close a CFC's taxable year if a significant ownership variance occurs. The collection of information in proposed §1.951-1(d)(2)(i) is satisfied by the controlling section 958(a) U.S. shareholders providing notice regarding the election to United States persons that own stock of a CFC during the taxable year that ends on the day on which the CFC's taxable year is treated as closing under proposed §1.951-1(d)(2), other than those persons required to enter into the binding agreement. The collection of information in proposed §1.951-1(d)(2)(iv) is satisfied by all controlling section 958(a) U.S. shareholders filing the "Elective Section 951 Year-Closing Statement" with a timely filed original Federal income tax return (including extensions) for the taxable year that includes the day the CFC's taxable year is treated as closing under proposed §1.951-1(d)(2).

The collection of information in proposed §1.951-4(h)(2) is mandatory for certain United States persons that are entitled to treat certain dividend amounts as a dividend for purposes of former section 951(a)(2)(B) as described in proposed §1.951-4(h)(2). The collection of information is satisfied by a United States person attaching a statement to Form 5471 that describes how the United States person determined that the dividend increased the taxable income of a United States person that is subject to Federal income tax for the taxable year, applying the rules in proposed §1.951-4.

The collection of information in proposed §1.6038-2(f)(8) is mandatory for U.S. shareholders. The collection of information is satisfied by completing Schedules A and B relating to the outstanding stock of a CFC and changes in direct and indirect ownership of the CFC as described in or as prescribed by Form 5471 and its instructions.

These reporting requirements will be included within OMB Control Numbers 1545-0123 for business filers, 1545-0074 for individual filers, 1545-0092 for trust and estate filers and 1545-0047 for tax exempt filers in accordance with the PRA procedures under 5 CFR 1320.10.

The recordkeeping requirements include that taxpayers keep books of account and records that are adequate to permit verification that the reduction in the taxpayer's pro rata share under former section 951(a)(2)(B) was appropriate and that the taxpayer is reporting the correct amount of taxable income. The recordkeeping requirements also include that certain taxpayers enter into a binding agreement with other shareholders as described in part II.D.3 of the Explanation of Provisions.

All recordkeeping requirements will be included within OMB Control Numbers 1545-0123 for business filers, 1545-0074 for individual filers, 1545-0092 for trust and estate filers, and 1545-0047 for tax exempt filers in accordance with the PRA procedures under 5 CFR 1320.10.

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 substantial 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* U.S.C. 601(3) through (6).

It is hereby certified that the proposed regulations will not have a significant economic impact on a substantial number of small entities. The Treasury Department and the IRS have determined that the regulations may affect a substantial number of small entities but do not expect that the proposed regulations will have a significant economic impact on affected small entities within the meaning of sections 601(3) through (6) of the RFA. The proposed regulations provide guidance on issues regarding sections 951 and 951A and related provisions but do not change the economic impact of the existing regulations or impose any new costs on small entities. The proposed regulations would modify some existing reporting requirements as discussed in part II of this Special Analyses, but the modifications are not expected to impose significant costs on any entities. Notwithstanding this certification, the Treasury Department and the IRS welcome comments from the public about the impact of these regulations on small entities.

IV. *Submission to the Small Business Administration*

Pursuant to section 7805(f) of the Code, the proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

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. In 2026, that threshold is approximately $214 million. The proposed 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.

VI. *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 proposed regulations do not have federalism implications, do not impose substantial direct compliance costs on State and local governments, and do not preempt State law within the meaning of the Executive order.

Comments and Requests for a Public Hearing

Consideration will be given to comments that are submitted timely to the IRS as prescribed in the preamble under the "**ADDRESSES**" section. In addition to the comments specifically requested in the Explanation of Provisions, the Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any 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 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**. Public hearings will be conducted in person with a telephonic option for individuals who wish to attend or testify at the hearing by telephone. Hearings will be made accessible to people with disabilities.

Statement of Availability of IRS Documents

Any IRS Revenue Procedures, Revenue Rulings, Notices, or other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *www.irs.gov*.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping 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 revising the entry for §1.951-1 and adding entries in numerical order for §1.951-4 and §1.951A-1 to read in part as follows:

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

* * * * *

Section 1.951-1 also issued under 26 U.S.C. 951, 951(a)(4), and 7701(a).

Section 1.951-4 also issued under section 70354(c)(2), Pub. L. 119-21, 139 Stat. 72.

Section 1.951A-1 also issued under 26 U.S.C. 951(a)(4) and 951A.

* * * * *

Par. 2. Section 1.245A-5 is amended by:

1. Revising the last sentence of paragraph (a);

2. Revising paragraph (d)(1)(ii);

3. Revising the second sentence of paragraph (j)(3)(ii)(D);

4. Revising paragraph (k)(1); and

5. Adding paragraphs (k)(3) and (4).

The revisions and additions read as follows:

§1.245A-5 Limitation of section 245A deduction and section 954(c)(6) exception.

(a) * * * Paragraph (k) of this section provides the applicability date of this section, including a rule that provides that the extraordinary reduction rules described in paragraphs (e) and (f) of this section do not apply to taxable periods of foreign corporations beginning after December 31, 2025.

* * * * *

(d) * * *

(1) * * *

(ii) The percentage of the upper-tier CFC's subpart F income that would be included in a United States shareholder's income under section 951(a) with respect to the upper-tier CFC's taxable year, determined without regard to the application of section 954(c)(6).

* * * * *

(j) * * *

(3) * * *

(ii) * * *

(D) * * * The percentage of CFC1's subpart F income for its taxable year that would be included in a United States shareholder's income is 100%. * * *

* * * * *

(k) *Applicability date*—(1) *In general*. Except as provided in paragraphs (k)(3) and (4) of this section, this section applies to taxable periods of a foreign corporation ending on or after June 14, 2019, and to taxable periods of section 245A shareholders in which or with which such taxable periods end.

* * * * *

(3) *Phaseout of extraordinary reduction rules.* Paragraphs (b)(2)(ii), (e), and (f) of this section do not apply to taxable periods of foreign corporations beginning after December 31, 2025.

(4) *Modification of extraordinary disposition rules*. Paragraphs (d)(1)(ii) and (j)(3)(ii)(D) of this section apply to taxable periods of foreign corporations beginning after December 31, 2025, and to taxable periods of section 245A shareholders in which or with which such taxable periods end. For rules that apply to taxable periods of foreign corporations beginning on or before December 31, 2025, see §1.245A-5 as contained in 26 CFR part 1 edition revised as of April 1, 2026.

Par. 3. Section 1.901-2 is amended by revising paragraph (f)(6) to read as follows:

§1.901-2 Income, war profits, or excess profits tax paid or accrued.

* * * * *

(f) * * *

(6) *Allocation of foreign income taxes in connection with certain elections and status change events*. For rules relating to the allocation of foreign income taxes in connection with elections made pursuant to section 336(e), *see* § 1.336-2(g)(3)(ii). For rules relating to the allocation of foreign income taxes in connection with elections made pursuant to section 338, *see* § 1.338-9(d). For rules relating to the allocation of foreign income taxes in connection with elections made pursuant to § 1.245A-5(e)(3)(i), *see* § 1.245A-5(e)(3)(i)(B) (applicable to taxable periods of foreign corporations beginning before December 31, 2025). For rules relating to the allocation of foreign income taxes in connection with an election pursuant to § 1.951-1(d)(2) or a status change event under § 1.951-1(d)(1), *see* § 1.951-1(d)(3).

* * * * *

Par. 4. Section 1.951-1 is amended by:

1. Revising paragraphs (a), (b), (d) through (f), and (h); and

2. Adding paragraph (i).

The revisions and addition read as follows:

§1.951-1 Amounts included in gross income of United States shareholders.

(a) *Scope.* This section sets forth the rules for determining amounts included in the gross income of a United States shareholder under section 951(a). Paragraph (b) of this section provides the general rule for amounts required to be included in gross income under section 951(a)(1)(A) and (B). Paragraph (c) of this section is reserved. Paragraph (d) of this section provides rules that require or permit the closing of the taxable year of a foreign corporation, which, if applicable, are necessary to determine the CFC year with respect to which a United States shareholder determines its pro rata share of subpart F income. Paragraph (e) of this section prescribes the rules for determining a United States shareholder's pro rata share of subpart F income for a CFC year. Paragraph (f) of this section provides a rule for determining the holding period of an asset (including stock of a controlled foreign corporation). Paragraph (g) of this section defines United States shareholder. Paragraph (h) of this section provides additional definitions. Paragraph (i) of this section provides applicability dates. For rules applying this section to foreign controlled United States shareholders and foreign controlled foreign corporations, see section 951B (generally replacing references in this section to the term "United States shareholder" with the term "foreign controlled United States shareholder" and the term "controlled foreign corporation" with the term "foreign controlled foreign corporation").

(b) *In general*—(1) *Section 951(a)(1)(A) inclusions*. Each United States shareholder of a foreign corporation that owns stock in the foreign corporation on any day during a CFC year of the foreign corporation must, for the United States shareholder's taxable year that includes the last day on which the shareholder owns stock in the foreign corporation during the CFC year, include in gross income the United States shareholder's pro rata share (determined under paragraph (e) of this section) of the foreign corporation's subpart F income for the CFC year.

(2) *Section 951(a)(1)(B) inclusions*. Each United States shareholder of a foreign corporation that owns stock in the foreign corporation on the last day of a CFC year on which the foreign corporation is a controlled foreign corporation must, for the United States shareholder's taxable year that includes the last day on which the shareholder owns stock in the foreign corporation during the CFC year, include in gross income the amount determined under section 956 with respect to the United States shareholder for the CFC year, but only to the extent not excluded

from gross income under section 959(a)(2).

(3) *Personal holding company determination*. For purposes of determining whether a United States shareholder that is a domestic corporation is a personal holding company under section 542 and §1.542-1, the character of the amount includible in gross income of such domestic corporation under this paragraph (b) is determined as if such amount were realized directly by such domestic corporation from the source from which it is realized by the controlled foreign corporation.

(4) *Cross references*. *See* §1.957-2(a) for a special limitation on the amount of subpart F income in the case of a controlled foreign corporation described in section 957(b) (involving insurance income). *See* section 970(a) and §1.970-1 for rules that reduce subpart F income of controlled foreign corporations that are export trade corporations.

* * * * *

(d) *Certain taxable year determinations*—(1) *Required closing of foreign corporation's taxable year*—(i) *In general*. If a status change event occurs with respect to a foreign corporation, the taxable year of the foreign corporation closes for all purposes of the Internal Revenue Code (and, therefore, as to all shareholders of the foreign corporation) under this paragraph (d)(1) as of the end of the day on which the status change event occurs, unless the taxable year otherwise closes as of such day under another provision of the Internal Revenue Code.

(ii) *Status change event.* A *status change event* occurs if a foreign corporation becomes or ceases to be a controlled foreign corporation. For purposes of paragraph (d)(1)(i) of this section, in the case of a foreign corporation becoming a controlled foreign corporation, the status change event occurs on the last day that the foreign corporation is not a controlled foreign corporation, and in the case of a foreign corporation ceasing to be a controlled foreign corporation, the status change event occurs on the last day that the foreign corporation is a controlled foreign corporation.

(iii) *Special rules for domestic partnerships and options*. Solely for purposes of determining whether a status change event occurs with respect to a foreign corporation—

(A) §1.958-1(d)(1) is applied without regard to the exceptions in §1.958-1(d)(2)(i) and (ii), and

(B) Section 318(a)(4) and §1.958-2(e) do not apply.

(2) *Elective closing of controlled foreign corporation's taxable year*—(i) *In general*. If a significant ownership variance occurs with respect to a controlled foreign corporation, all the controlling section 958(a) U.S. shareholders of the controlled foreign corporation may elect to close the controlled foreign corporation's taxable year for all purposes of the Internal Revenue Code (and, therefore, as to all shareholders of the controlled foreign corporation) under this paragraph (d)(2) as of the end of the day on which the significant ownership variance occurs, unless the taxable year otherwise closes as of such day under another provision of the Internal Revenue Code. If the election is made, all persons that own stock of the controlled foreign corporation (regardless of whether they are controlling section 958(a) U.S. shareholders) must file their respective Federal income tax returns and information returns consistently with the election. The closing of the controlled foreign corporation's taxable year is treated as a change in taxable year for purposes of the notice requirement in §1.964-1(c)(3)(iii), treating the controlling section 958(a) U.S. shareholders as the controlling domestic shareholders of the foreign corporation for this purpose. The notice described in §1.964-1(c)(3)(iii) must be provided to all United States persons that own stock of the controlled foreign corporation during the taxable year that ends on the day on which the controlled foreign corporation's taxable year closes under this paragraph (d)(2), other than those persons required to enter into the binding agreement described in paragraph (d)(2)(iv)(B) of this section.

(ii) *Significant ownership variance*—(A) *In general*. A *significant ownership variance* occurs if, taking into account all specified transfers that occur pursuant to the same plan during the same taxable year of a controlled foreign corporation (such taxable year determined without regard to this paragraph (d)(2)), the percentage of the outstanding stock of the controlled foreign corporation owned by one or more section 958(a) U.S. shareholders of the controlled foreign corporation decreases, in the aggregate, by more than 50 percentage points (by vote or value), as compared to the percentage of stock of the controlled foreign corporation owned by those section 958(a) U.S. shareholders immediately before the first such specified transfer. For purposes of paragraph (d)(2)(i) of this section, the significant ownership variance occurs on the day that the last specified transfer taken into account in the significant ownership variance occurs.

(B) *Specified trans*fer. A *specified transfer* is—

(*1*) A sale, exchange, or any other disposition of one or more shares of stock of a foreign corporation or of a partnership interest by the same person on the same date, including a redemption of stock within the meaning of section 317(b) or a change in a partner's interest in a partnership as a result of a distribution or redemption, or

(*2*) An issuance of one or more shares of stock of a foreign corporation, an issuance of a partnership interest, or a change in a partner's interest in a partnership as a result of a contribution of property or services to the partnership, in each case occurring on the same date.

(C) *Special rules for related persons and certain reorganizations*. Solely for purposes of applying paragraph (d)(2)(ii)(A) of this section—

(*1*) The total percentage of the outstanding stock of the controlled foreign corporation owned by one or more section 958(a) U.S. shareholders is not treated as decreasing to the extent that, taking into account all the specified transfers referred to in paragraph (d)(2)(ii)(A) of this section, a United States person that is a related person, immediately following the last such specified transfer, with respect to any section 958(a) U.S. shareholder whose percentage of ownership of stock of the controlled foreign corporation decreased (determined without regard to this paragraph (d)(2)(ii)(C)(*1*)), has an increase in its percentage of ownership of stock of the controlled foreign corporation; and

(*2*) The transferor corporation and the resulting corporation (as defined in §1.368-2(m)(1)) in a reorganization described under section 368(a)(1)(F) are treated as the same corporation.

(iii) *Certain United States shareholders*—(A) *Section 958(a) U.S. shareholders*. The *section 958(a) U.S. shareholders* of a controlled foreign corporation are the United States shareholders that own stock of the controlled foreign corporation.

(B) *Controlling section 958(a) U.S. shareholders.* The *controlling section 958(a) U.S. shareholders* of a controlled foreign corporation are the section 958(a) U.S. shareholders (or, if applicable, single section 958(a) U.S. shareholder) whose percentage of ownership of stock of the controlled foreign corporation decreases as part of a significant ownership variance.

(iv) *Time and manner of making election*—(A) *Election by controlling section 958(a) U.S. shareholders*. An election pursuant to this paragraph (d)(2) is made and effective if each controlling section 958(a) U.S. shareholder files the statement described in paragraph (d)(2)(v) of this section with its timely filed original Federal income tax return (including extensions) for the taxable year that includes the day the controlled foreign corporation's taxable year closes under this paragraph (d)(2). If a controlling section 958(a) U.S. shareholder is a member of a consolidated group (within the meaning of §1.1502-1(h)), the agent for the group (within the meaning of §1.1502-77(c)(1)) makes the election by filing the statement described in paragraph (d)(2)(v) of this section on behalf of such member.

(B) *Binding agreement*. Before the filing of the statement described in paragraph (d)(2)(v) of this section, all the controlling section 958(a) U.S. shareholders and all other section 958(a) U.S. shareholders of the controlled foreign corporation (if any) that own stock of the controlled foreign corporation on any day of the controlled foreign corporation's taxable year up to and including the day that the significant ownership variance occurs must enter into a written, binding agreement requiring the controlling section 958(a) U.S. shareholders to make the election described in this paragraph (d)(2). Each party to this binding agreement must be able to present the agreement to the Internal Revenue Service for inspection upon request. No binding agreement is required under this paragraph (d)(2)(iv)(B) if there is a single controlling section 958(a) U.S. shareholder and there is no other section 958(a) U.S. shareholder of the controlled foreign corporation that owns stock of the controlled foreign corporation on any day of the controlled foreign corporation's taxable year up to and including the day that the significant ownership variance occurs. In the case of a section 958(a) U.S. shareholder that owns stock of the controlled foreign corporation indirectly through one or more partnerships, the partnership that directly holds the stock of the controlled foreign corporation may enter into the binding agreement on behalf of the United States shareholder partner provided that, before the due date of the partner's original Federal income tax return, including extensions, the partner delegated the authority to the partnership to enter into the binding agreement pursuant to a written partnership agreement (within the meaning of §1.704-1(b)(2)(ii)(*h*)).

(v) *Form and content of statement*. The statement required by paragraph (d)(2)(iv) of this section must be titled "Elective Section 951 Year-Closing Statement." The statement must—

(A) Identify (by name and tax identification number, if any) the controlled foreign corporation, the controlling section 958(a) U.S. shareholders, and each other section 958(a) U.S. shareholder of the controlled foreign corporation that is party to the binding agreement referred to in paragraph (d)(2)(iv)(B) of this section;

(B) Describe the significant ownership variance to which the election applies and provide the date on which the controlled foreign corporation's taxable year closes;

(C) State that each controlling section 958(a) U.S. shareholder and all other section 958(a) U.S. shareholders of the controlled foreign corporation described in paragraph (d)(2)(iv)(B) of this section have entered into a written, binding agreement to elect to close the controlled foreign corporation's taxable year in accordance with paragraph (d)(2)(iv)(B) of this section; and

(D) Be filed in the manner, if any, prescribed by forms, publications, or other guidance published in the Internal Revenue Bulletin.

(vi) *Consistency requirement*. If significant ownership variances occur with respect to multiple controlled foreign corporations pursuant to a plan or series of related transactions, the election described in this paragraph (d)(2) may be made only if it is made with respect to each of the controlled foreign corporations.

(3) *Foreign income taxes*—(i) *Allocation to taxable years.* If a foreign corporation's taxable year closes under paragraph (d)(1) or (d)(2) of this section and the foreign corporation's taxable year under foreign law does not close at the end of the date on which the foreign corporation's taxable year closes (the closing date), a portion of the foreign income tax with respect to such foreign taxable year that accrues in the taxable year following the closing date is allocated to the taxable year ending with the closing date. The allocation is made based on the portion of the taxable income of the foreign corporation (as determined under foreign law) for the foreign taxable year that is attributable under the principles of §1.1502-76(b) (without regard to §1.1502-76(b)(2)(ii)) to the period of the foreign taxable year ending with the closing date. This paragraph (d)(3) applies to all foreign income taxes for which the foreign corporation is the taxpayer under §1.901-2(f) (other than withholding taxes as defined in section 901(k)(1)(B)). Foreign income taxes allocated to a taxable year under this paragraph (d)(3) are treated as accrued by the foreign corporation as of the close of that taxable year for all purposes of the Internal Revenue Code except for section 986(a).

(ii) *Allocation and apportionment to statutory and residual groupings*. The portion of the foreign income tax allocated under paragraph (d)(3)(i) of this section to the taxable year ending with the closing date is allocated and apportioned to statutory and residual groupings under §1.861-20 by treating the foreign taxable income attributed under paragraph (d)(3)(i) of this section to the period of the foreign taxable year ending with the closing date as the foreign income included in the base on which the tax is imposed. The portion of the foreign income tax that remains in the taxable year following the closing date is allocated and apportioned to statutory and residual groupings under §1.861-20 by treating the remaining foreign taxable income as the foreign income included in the base on which the tax is imposed.

(4) *Examples*. The following examples illustrate the application of this paragraph (d).

(i) *Example 1: Status change event*—(A) *Facts*. FC is a foreign corporation with a calendar taxable year. As of January 1 of Year 1, 100 percent of the stock of FC is owned by USP, a domestic corporation. On June 30 of Year 1, USP sells all its stock in FC to Individual A, a nonresident alien individual.

(B) *Analysis*. Under paragraph (f)(1) of this section, USP owns the stock of FC through June 30 of Year 1. Individual A owns the stock of FC on July 1 of Year 1. FC is therefore a controlled foreign corporation through June 30 of Year 1 and is not a controlled foreign corporation on July 1 of Year 1. Under paragraph (d)(1)(ii) of this section, a status change event occurs with respect to FC on June 30 of Year 1, which is the last day that FC is a controlled foreign corporation. Therefore, under paragraph (d)(1)(i) of this section, the taxable year of FC closes for all purposes of the Internal Revenue Code as of the end of the day on June 30 of Year 1.

(ii) *Example 2: Significant ownership variance*—(A) *Facts*. The facts are the same as in paragraph (d)(4)(i)(A) of this section (*Example 1*), except that Individual A is a United States citizen. USP and Individual A are not related persons.

(B) *Analysis.* Paragraph (d)(1) of this section does not apply to the sale of stock of FC by USP to Individual A because the sale does not result in FC ceasing to be a controlled foreign corporation. Under paragraph (d)(2)(ii)(B) of this section, the sale of stock of FC by USP to Individual A is a specified transfer. Under paragraph (d)(2)(ii)(B) of this section, USP is a section 958(a) U.S. shareholder of FC prior to the sale. Under paragraph (f)(1) of this section, USP owns the stock of FC through June 30 of Year 1, and Individual A owns the stock of FC on July 1 of Year 1. Under paragraph (d)(2)(ii)(A) of this section, USP's sale of all the stock of FC to Individual A results in a significant ownership variance that occurs on June 30 of Year 1. A significant ownership variance occurs because, taking into account the sale, the percentage of the outstanding stock of FC owned by USP decreases, in the aggregate, by more than 50 percentage points (by vote or value), as compared to the percentage of stock of FC owned by USP immediately before the sale (from 100 percent to 0 percent). Under paragraph (d)(2)(iii)(B) of this section, USP is the single controlling section 958(a) U.S. shareholder of FC. Therefore, pursuant to paragraph (d)(2)(i) of this section, USP may elect to close the taxable year of FC for all purposes of the Internal Revenue Code as of the end of the day on June 30 of Year 1.

(iii) *Example 3: Transfer between related persons*—(A) *Facts*. The facts are the same as in paragraph (d)(4)(ii)(A) of this section (*Example 2*), except that USP and Individual A are related persons.

(B) *Analysis.* Paragraph (d)(1) of this section does not apply to the sale of stock of FC by USP to Individual A because the sale does not result in FC ceasing to be a controlled foreign corporation. Under paragraph (d)(2)(ii)(B) of this section, the sale of stock of FC by USP to Individual A is a specified transfer. Under paragraph (d)(2)(iii)(A) of this section, USP is a section 958(a) U.S. shareholder of FC prior to the sale. Under paragraph (f)(1) of this section, USP owns the stock of FC through June 30 of Year 1, and Individual A owns the stock of FC on July 1 of Year 1. Under paragraph (d)(2)(ii)(C) of this section, solely for purposes of applying paragraph (d)(2)(ii)(A) of this section, the total percentage of the outstanding stock of FC owned by one or more section 958(a) U.S. shareholders is not treated as decreasing as a result of the sale because Individual A is a United States person that is a related person, immediately following the sale, with respect to USP, and the sale results in an increase in Individual A's percentage of ownership of stock of FC by 100 percent (entirely offsetting the 100 percent decrease in USP's percentage of ownership of stock of FC). Therefore, the sale does not give rise to a significant ownership variance and USP may not elect to close the taxable year of FC.

(e) *Pro rata share of subpart F income defined*—(1) *Overview*. This paragraph (e) determines a United States shareholder's pro rata share of a controlled foreign corporation's subpart F income for a CFC year. Paragraph (e)(2) of this section contains the rules for determining a United States shareholder's pro rata share of subpart F income. Paragraph (e)(3) of this section sets forth an anti-abuse rule, and paragraph (e)(4) of this section contains examples.

(2) *In general.* A United States shareholder's pro rata share of a controlled foreign corporation's subpart F income for a CFC year is the portion of the subpart F income attributable to the stock of the foreign corporation that the United States shareholder owns during the period of the CFC year in which the United States shareholder owns the stock, the shareholder is a United States shareholder of the foreign corporation, and the foreign corporation is a controlled foreign corporation, as determined under the rules of this paragraph (e)(2).

(i) *One class of stock with constant number of shares outstanding*—(A) *Daily proration*. Subject to paragraph (e)(2)(i)(B) of this section, if the controlled foreign corporation has only one class of stock outstanding at all times during the CFC year and there is no change in the number of outstanding shares of the controlled foreign corporation during the CFC year, a United States shareholder's pro rata share of the controlled foreign corporation's subpart F income is equal to the subpart F income of the controlled foreign corporation for the CFC year multiplied by the product of—

(*1*) A fraction, the numerator of which is the number of shares of the controlled foreign corporation the United States shareholder owned during the CFC year, and the denominator of which is the number of shares of the controlled foreign corporation outstanding for the CFC year, and

(*2*) A fraction, the numerator of which is the number of days the United States shareholder owned the shares of the controlled foreign corporation while a United States shareholder of the foreign corporation and while the foreign corporation was a controlled foreign corporation during the CFC year, and the denominator of which is the number of days in the CFC year.

(B) *Stock with different ownership periods during CFC year*—(*1*) In general. If a United States shareholder owns shares in more than one CFC year block during a CFC year (for example, because the United States shareholder acquires or disposes of a portion of its shares during the CFC year), paragraph (e)(2)(i)(A) of this section is applied separately to each CFC year block, and the United States shareholder's pro rata share of the controlled foreign corporation's subpart F income for the CFC year is equal to the total amount determined with respect to all of its CFC year blocks. *See* paragraph (e)(4)(iii) of this section (*Example 2*).

(2) Definition of CFC year block. The term CFC year block means a group of shares within a class of stock of a controlled foreign corporation that a United States shareholder owns for the same period during a CFC year.

(ii) *More than one class of stock with constant number of shares outstanding in each class.* If a controlled foreign corporation has more than one class of stock outstanding during a CFC year and there is no change in the number of outstanding shares in any class of the controlled foreign corporation's stock during the CFC year, paragraph (e)(2)(i) of this section is applied separately to each class of stock after first allocating the controlled foreign corporation's subpart F income for the CFC year among the classes of stock. For this purpose, the amount of subpart F income for the CFC year allocated to a class of stock of a controlled foreign corporation is the amount that bears the same ratio to the corporation's subpart F income for the CFC year as the amount of the corporation's allocable earnings and profits that would be distributed with respect to the class of stock bears to the total amount of the corporation's allocable earnings and profits that would be distributed with respect to all the stock of the corporation if all the allocable earnings and profits of the corporation for the CFC year (not reduced by actual distributions during the year) were distributed (hypothetical distribution) on the last day of the CFC year.

(A) *Definition of allocable earnings and profits.* The term allocable earnings and profits means, with respect to a controlled foreign corporation for a CFC year, the amount that is the greater of—

(*1*) The earnings and profits of the corporation for the CFC year determined under section 964, and

(*2*) The sum of the subpart F income (as determined under section 952 after the application of section 951A(b)(2)(B)(ii) and §1.951A-6(b)) of the corporation for the CFC year and the tested income of the corporation for the CFC year.

(B) *Hypothetical distribution analysis*. The amount of the controlled foreign corporation's allocable earnings and profits distributed in the hypothetical distribution with respect to each class of stock is determined based on the distribution rights of the stock during the CFC year. Subject to paragraphs (e)(2)(ii)(C) and (D), and (e)(3), of this section, the distribution rights of a class of stock are determined taking into account all facts and circumstances related to the economic rights and interest in the allocable earnings and profits of the corporation of each class, including the terms of the class of stock, any agreement among the shareholders and, if and to the extent appropriate, the relative fair market value of shares of stock. For purposes of this paragraph (e)(2)(ii)(B), facts and circumstances do not include actual distributions (including distributions by redemption) or any amount treated as a dividend under any other provision of subtitle A of the Internal Revenue Code (for example, under section 78, 356(a)(2), 367(b), or 1248) made during the CFC year.

(C) *Special rules*—(*1*) *Redemptions, liquidations, and returns of capital*. No amount of allocable earnings and profits is distributed in the hypothetical distribution with respect to a particular class of stock based on the terms of the class of stock of the controlled foreign corporation or any agreement or arrangement with respect thereto that would result in a redemption (even if such redemption would be treated as a distribution of property to which section 301 applies pursuant to section 302(d)), a distribution in liquidation, or a return of capital.

(*2*) *Certain cumulative preferred stock*. If a controlled foreign corporation has outstanding a class of redeemable preferred stock with cumulative dividend rights and dividend arrearages on such stock do not compound at least annually at a rate that equals or exceeds the applicable Federal rate (as defined in section 1274(d)(1)) that applies on the date the stock is issued for the term from such issue date to the mandatory redemption date based on a comparable compounding assumption (the relevant AFR), the amount of the corporation's allocable earnings and profits distributed in the hypothetical distribution with respect to the class of stock may not exceed the amount of dividends actually paid during the CFC year with respect to the class of stock plus the present value at the end of the CFC year of the unpaid current dividends with respect to the class determined using the relevant AFR and assuming the dividends will be paid at the mandatory redemption date. For purposes of this paragraph (e)(2)(ii)(C)(*2*), if the class of preferred stock does not have a mandatory redemption date, the mandatory redemption date is the date that the class of preferred stock is expected to be redeemed based on all facts and circumstances.

(*3*) *Dividend arrearages*. If there is an arrearage in dividends for prior taxable years with respect to a class of preferred stock of a controlled foreign corporation, an amount of the corporation's allocable earnings and profits is distributed in the hypothetical distribution to the class of preferred stock by reason of the arrearage only to the extent the arrearage exceeds the accumulated earnings and profits of the controlled foreign corporation remaining from prior CFC years beginning after December 31, 1962, as of the beginning of the CFC year, or the date on which such stock was issued, whichever is later (the applicable date). If there is an arrearage in dividends for prior CFC years with respect to more than one class of preferred stock, the previous sentence is applied to each class in order of priority, except that the accumulated earnings and profits remaining after the applicable date are reduced by the allocable earnings and profits necessary to satisfy arrearages with respect to classes of stock with a higher priority. For purposes of this paragraph (e)(2)(ii)(C)(*3*), the amount of any arrearage with respect to stock described in this paragraph (e)(2)(ii)(C)(*3*) is determined in the same manner as the present value of unpaid current dividends on such stock under paragraph (e)(2)(ii)(C)(*2*) of this section.

(D) *Restrictions or other limitations on distributions*—(*1*) *In general*. A restriction or other limitation on distributions of an amount of earnings and profits by a controlled foreign corporation is not taken into account in determining the amount of the corporation's allocable earnings and profits distributed in the hypothetical distribution to a class of stock of the controlled foreign corporation.

(*2*) *Definition of restriction or other limitation*. For purposes of paragraph (e)(2)(ii)(D)(*1*) of this section, a restriction or other limitation on distributions includes any limitation that has the effect of limiting the distribution of an amount of earnings and profits by a controlled foreign corporation with respect to a class of stock of the corporation, other than currency or other restrictions or limitations imposed under the laws of any foreign country as provided in section 964(b).

(*3*) *Exception for certain preferred distributions.* For purposes of paragraph (e)(2)(ii)(D)(*1*) of this section, the right to receive periodically a fixed amount (whether determined by a percentage of par value, a reference to a floating coupon rate, a stated return expressed in terms of a certain amount of U.S. dollars or foreign currency, or otherwise) with respect to a class of stock the distribution of which is a condition precedent to a further distribution of earnings and profits that year with respect to any class of stock (not including a distribution in partial or complete liquidation) is not a restriction or other limitation on the distribution of earnings and profits by a controlled foreign corporation.

(*4*) *Illustrative list of restrictions and limitations*. Except as provided in paragraph (e)(2)(ii)(D)(*3*) of this section, restrictions or other limitations on distributions include, but are not limited to—

(*i*) An arrangement that restricts the ability of a controlled foreign corporation to pay dividends on a class of stock of the corporation until a condition or conditions are satisfied (for example, until another class of stock is redeemed);

(*ii*) A loan agreement entered into by a controlled foreign corporation that restricts or otherwise affects the ability to make distributions on its stock until certain requirements are satisfied; or

(*iii*) An arrangement that conditions the ability of a controlled foreign corporation to pay dividends to its shareholders on the financial condition of the corporation.

(iii) *Changes in number of shares outstanding*. If the number of shares within any class of stock of a controlled foreign corporation outstanding on each day of a CFC year changes (for example, because of an issuance of new shares or a redemption of outstanding shares), a United States shareholder's pro rata share of subpart F income is determined under the rules provided in paragraphs (e)(2)(i) and (ii) of this section as modified by this paragraph (e)(2)(iii).

(A) *Weighted average share count*. For purposes of applying paragraph (e)(2)(i) of this section, a United States shareholder's pro rata share of subpart F income is determined by substituting a weighted average share count for the number of the controlled foreign corporation's shares outstanding during the CFC year, which is equal to the sum of the number of shares outstanding on each day of the CFC year divided by the number of days in the CFC year.

(B) *Multiple classes of stock*. For purposes of applying paragraph (e)(2)(ii) of this section, a controlled foreign corporation's subpart F income for the CFC year is allocated among classes of stock based on the allocable earnings and profits that would be distributed to a class of stock in the hypothetical distribution if a weighted average share count of the class was outstanding on each day of the CFC year and, thus, on the last day of the CFC year when the hypothetical distribution occurs.

(3) *Transactions and arrangements with a principal purpose of changing pro rata shares*. Appropriate adjustments must be made to the allocation of allocable earnings and profits that would be distributed (without regard to this paragraph (e)(3)) in a hypothetical distribution with respect to any share of stock to disregard the effect on the hypothetical distribution of any transaction or arrangement that is undertaken as part of a plan a principal purpose of which is the avoidance of Federal income taxation by changing the amount of allocable earnings and profits that would be distributed in any hypothetical distribution with respect to such share. This paragraph (e)(3) also applies for purposes of the pro rata share rules described in §1.951A-1(d) that reference this paragraph (e).

(4) *Examples*. The following examples illustrate the application of this paragraph (e).

(i) *Facts*. Except as otherwise stated, the following facts are assumed for purposes of the examples:

(A) FC1 is a controlled foreign corporation.

(B) USP1 and USP2 are domestic corporations that are United States shareholders of FC1.

(C) Individual A is a nonresident alien individual, and FC2 is a foreign corporation that is not a controlled foreign corporation.

(D) All persons use the calendar year as their taxable year.

(E) Year 1 has 365 days.

(F) Any ownership of stock of FC1 by any shareholder is for all of Year 1.

(G) The common shareholders of FC1 are entitled to dividends when declared by FC1's board of directors.

(H) There are no accrued but unpaid dividends with respect to preferred shares, the preferred stock is not described in paragraph (e)(2)(ii)(C)(*2*) of this section, and common shares have positive liquidation value.

(I) There are no other facts and circumstances related to the economic rights and interest of any class of stock in the allocable earnings and profits of a foreign corporation, and no transaction or arrangement was entered into as part of a plan a principal purpose of which is the avoidance of Federal income taxation.

(J) FC1 has neither tested income nor tested loss.

(K) None of the transactions described constitute a status change event or a significant ownership variance.

(ii) *Example 1*: *One class of stock with constant number of shares outstanding*—(A) *Facts*. FC1 has outstanding 100 shares of one class of stock. USP1 owns 60 shares of FC1. USP2 owns 40 shares of FC1. For Year 1, FC1 earns $100x of subpart F income.

(B) *Analysis*. FC1 has one class of stock and the number of shares outstanding does not change during Year 1, which is a CFC year. Therefore, USP1's and USP2's pro rata shares of FC1's subpart F income for the CFC year are determined under paragraph (e)(2)(i) of this section. For Year 1, USP1's pro rata share of FC1's subpart F income is $60x, which is equal to $100x of subpart F income multiplied by the product of two fractions. For the first fraction, the numerator is the number of shares that USP1 owned (60) and the denominator is the number of shares of FC1 outstanding (100) (60 percent). For the second fraction, the numerator is the number of days in the CFC year that USP1 owned the shares while USP1 was a United States shareholder of FC1 and FC1 was a controlled foreign corporation (365) and the denominator is the number of days in the CFC year of FC1 (365) (100 percent). For Year 1, USP2's pro rata share of FC1's subpart F income is $40x, which is equal to $100x of subpart F income multiplied by the product of two fractions. For the first fraction, the numerator is the number of shares that USP2 owned (40) and the denominator is the number of shares of FC1 outstanding (100) (40 percent). For the second fraction, the numerator is the number of days in the CFC year that USP2 owned the shares while USP2 was a United States shareholder of FC1 and FC1 was a controlled foreign corporation (365) and the denominator is the number of days in the CFC year of FC1 (365) (100 percent).

(iii) *Example 2*: *Single class of stock with constant number of shares outstanding during the CFC year, and a share transfer during the CFC Year*—(A) *Facts*. The facts are the same as in paragraph (e)(4)(ii)(A) of this section (*Example 1*), except that on June 30 of Year 1 USP2 sells 20 shares of FC1 to Individual A.

(B) *Analysis*. The determination of USP1's pro rata share of the subpart F income of FC1 is the same as in paragraph (e)(4)(ii)(B) of this section (the analysis in *Example 1*). Under paragraph (e)(2)(i)(B) of this section, USP2's pro rata share of FC1's subpart F income is determined by reference to the two separate CFC year blocks that USP2 owns during the CFC year. USP2 owns 40 shares of FC1 from January 1 through June 30 of the CFC year (the first CFC year block), and 20 shares of FC1 from July 1 through December 31 of the CFC year (the second CFC year block). USP2's pro rata share of subpart F income with respect to the first CFC year block is $19.84x, which is equal to $100x of subpart F income multiplied by the product of two fractions. For the first fraction, the numerator is the number of shares USP2 owned in the first CFC year block (40) and the denominator is the number of shares of FC1 outstanding (100) (40 percent). For the second fraction, the numerator is the number of days in the CFC year that USP2 owned the shares in the first CFC year block while USP2 was a United States shareholder of

FC1 and FC1 was a controlled foreign corporation (181) and the denominator is the number of days in the CFC year (365) (49.6 percent). USP2's pro rata share of subpart F income with respect to the second CFC year block is $10.08x, which is equal to $100x of subpart F income multiplied by the product of two fractions. For the first fraction, the numerator is the number of shares USP2 owned in the second CFC year block (20) and the denominator is the number of shares of FC1 outstanding (100) (20 percent). For the second fraction, the numerator is the number of days in the CFC year that USP2 owned the shares in the second CFC year block while USP2 was a United States shareholder of FC1 and FC1 was a controlled foreign corporation (184) and the denominator is the number of days in the CFC year (365) (50.4 percent). Accordingly, for Year 1, USP2's pro rata share of the subpart F income of FC1 is $29.92x ($19.84x + $10.08x).

(iv) *Example 3*: *Common and preferred stock*—(A) *Facts*. FC1 has outstanding 70 shares of common stock and 30 shares of 4% nonparticipating, voting preferred stock with a par value of $10x per share. USP1 owns all the common shares. Individual A owns all the preferred shares. For Year 1, FC1 has $100x of earnings and profits and $50x of subpart F income.

(B) *Analysis*. FC1 has more than one class of stock and the number of shares outstanding in each class does not change during Year 1, which is a CFC year. Therefore, USP1's pro rata share of FC1's subpart F income for the CFC year is determined under paragraph (e)(2)(i) of this section after applying the hypothetical distribution in paragraph (e)(2)(ii) of this section to determine the amount of subpart F income allocated to the common and preferred stock of FC1. The distribution rights of the preferred shares are not a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. Under paragraph (e)(2)(ii) of this section, the amount of FC1's allocable earnings and profits distributed in the hypothetical distribution with respect to Individual A's preferred shares is $12x (0.04 × $10x × 30) and with respect to USP1's common shares is $88x ($100x - $12x). Accordingly, under paragraph (e)(2)(ii) of this section, $6x of FC1's subpart F income is allocated to the preferred shares ($50x × ($12x/$100x)), and $44x of FC1's subpart F income is allocated to the common shares ($50x × ($88x/$100x)) for Year 1. As a result, under paragraph (e)(2)(i) of this section, because USP1 owned all the common shares, USP1's pro rata share of FC1's subpart F income is $44x for Year 1.

(v) *Example 4*: *Mid-year redemption of preferred stock*—(A) *Facts*. The facts are the same as in paragraph (e)(4)(iv)(A) of this section (*Example 3*), except on June 30 of Year 1, FC1 redeems 15 shares of the preferred stock owned by Individual A.

(B) *Analysis*. The redemption of the 15 shares of preferred stock of FC1 owned by Individual A is not taken into account in determining the distribution rights of the preferred stock under paragraph (e)(2)(ii)(B) of this section, and the distribution rights of the preferred shares are not a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. Under paragraph (e)(2)(ii) of this section, the amount of FC1's allocable earnings and profits distributed in the hypothetical distribution is determined based on the allocable earnings and profits that would be distributed with respect to the preferred shares if a weighted average share count of preferred shares was outstanding on each day of the CFC year and, thus, on the last day of the CFC year. The weighted average share count of the preferred shares is 22.44 ((15 × 365 + 15 × 181)/365). The allocable earnings and profits that would be distributed to Individual A's preferred shares based on the weighted average share count is $8.98x (0.04 × $10x × 22.44). The allocable earnings and profits that would be distributed with respect to USP1's common shares is $91.02x ($100x - $8.98x). Accordingly, under paragraph (e)(2)(ii) of this section, $45.51x of FC1's subpart F income is allocated to USP1's common shares ($50x × ($91.02x/$100x)), and USP1's pro rata share of FC1's subpart F income under paragraph (e)(2)(i) of this section is $45.51 for Year 1.

(vi) *Example 5: Restriction based on cumulative income*—(A) *Facts*. FC1 has outstanding 10 shares of common stock and 400 shares of 2% nonparticipating, voting preferred stock with a par value of $1x per share. USP1 owns all the common shares. FC2 owns all the preferred shares. USP1 and FC2 cause the governing documents of FC1 to provide that no dividends may be paid to the common shareholders until FC1 cumulatively earns $100,000x of income. For Year 1, FC1 has $50x of earnings and profits and $50x of subpart F income.

(B) *Analysis*. The agreement restricting FC1's ability to pay dividends to common shareholders until FC1 cumulatively earns $100,000x of income is a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. Therefore, the restriction is disregarded for purposes of determining the amount of FC1's allocable earnings and profits distributed in the hypothetical distribution to a class of stock. The distribution rights of the preferred shares are not a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. Under paragraph (e)(2)(ii) of this section, the amount of FC1's allocable earnings and profits distributed in the hypothetical distribution with respect to FC2's preferred shares is $8x (0.02 × $1x × 400) and with respect to USP1's common shares is $42x ($50x - $8x). Accordingly, under paragraphs (e)(2)(i) and (ii) of this section, USP1's pro rata share of FC1's subpart F income is $42x for Year 1 ($50x × ($42x/$50x)).

(vii) *Example 6: Redemption rights*—(A) *Facts*. FC1 has outstanding 40 shares of common stock and 10 shares of 4% nonparticipating, preferred stock with a par value of $50x per share. Pursuant to the terms of the preferred stock, FC1 has the right to redeem the preferred stock at any time, in whole or in part. FC2 owns all the preferred shares. USP1, wholly owned by FC2, owns all the common shares. Pursuant to the governing documents of FC1, no dividends may be paid to the common shareholders while the preferred stock is outstanding. For Year 1, FC1 has $100x of earnings and profits and $100x of subpart F income.

(B) *Analysis*. The agreement restricting FC1's ability to pay dividends to common shareholders while the preferred stock is outstanding is a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. Therefore, the restriction is disregarded for purposes of determining the amount of FC1's allocable earnings and profits distributed in the hypothetical distribution to a class of stock. Under paragraph (e)(2)(ii)(C)(*1*) of this section, no amount of allocable earnings and profits is distributed in the hypothetical distribution to the preferred shareholders in respect of FC1's right to redeem the preferred shares. This is the case regardless of the restriction on paying dividends to the common shareholders while the preferred stock is outstanding, and regardless of the fact that a redemption of FC2's preferred shares would be treated as a distribution to which section 301 applies under section 302(d) (due to FC2's constructive ownership of the common shares). Thus, neither the restriction on paying dividends to the common shareholders while the preferred stock is outstanding nor FC1's redemption rights with respect to the preferred shares affects the distribution of allocable earnings and profits in the hypothetical distribution to FC1's shareholders. However, the distribution rights of the preferred shares are not a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. As a result, the amount of FC1's allocable earnings and profits distributed in the hypothetical distribution with respect to FC2's preferred shares is $20x (0.04 × $50x × 10) and with respect to USP1's common shares is $80x ($100x - $20x). Accordingly, under paragraphs (e)(2)(i) and (ii) of this section, USP1's pro rata share of FC1's subpart F income is $80x for Year 1 ($100x × ($80x/$100x)).

(viii) *Example 7: Shareholder owns common and preferred stock*—(A) *Facts*. FC1 has outstanding 40 shares of common stock and 60 shares of 6% nonparticipating, nonvoting preferred stock with a par value of $100x per share. USP1 owns 30 shares of the common stock and 15 shares of the preferred stock during Year 1. The remaining 10 shares of common stock and 45 shares of preferred stock of FC1 are owned by Individual A. For Year 1, FC1 has $1,000x of earnings and profits and $500x of subpart F income.

(B) *Analysis*. The right of the holder of the preferred stock to receive 6% of par value is not a restriction or other limitation within the meaning of paragraph (e)(2)(ii)(D) of this section. The amount of FC1's allocable earnings and profits distributed in the hypothetical distribution with respect to FC1's preferred shares is $360x (0.06 × $100x × 60) and with respect to its common shares is $640x ($1,000x - $360x). As a result, under paragraph (e)(2)(ii) of this section, $180x of FC1's subpart F income is allocated to the preferred shares ($500x × ($360x/$1,000x)) and $320x of FC1's subpart F income is allocated to the common shares ($500x × ($640x/$1,000x)). Under paragraph (e)(2)(i) of this section, USP1's pro rata share of the subpart F income of FC1 is $285x, of which $45x is attributable to USP1's preferred shares ($180x × 15/60 × 365/365) and $240x is attributable to USP1's common shares ($320x × 30/40 × 365/365).

(ix) *Example 8: Subpart F income and tested income*—(A) *Facts*. FC1 has outstanding 700 shares of common stock and 300 shares of 4% nonparticipating, voting preferred stock with a par value of $100x per share. USP1 owns all the common shares. USP2 owns all the preferred shares. For Year 1, FC1 has $10,000x of earnings and profits, $2,000x of subpart F income, and $9,000x of tested income.

(B) *Analysis*—(*1*) *Hypothetical distribution*. The allocable earnings and profits of FC1 determined under paragraph (e)(2)(ii)(A) of this section are $11,000x, the greater of FC1's earnings and profits as determined under section 964 ($10,000x) or the sum of FC1's subpart F income and tested income ($2,000x + $9,000x). The amount of FC1's allocable earnings and profits distributed in the hypothetical distribution with respect to USP2's preferred shares is $1,200x (0.04 × $100x × 300) and with respect to USP1's common shares is $9,800x ($11,000x - $1,200x).

(*2*) *Pro rata share of subpart F income*. Under paragraph (e)(2)(ii) of this section, $1,782x of FC1's subpart F income is allocated to the common shares ($2,000x × ($9,800x/$11,000x)) and $218x of FC1's subpart F income is allocated to the preferred shares ($2,000x × ($1,200x/$11,000x)). Accordingly, under paragraph (e)(2)(i) of this section, for Year 1, USP1's pro rata share of FC1's subpart F income is $1,782x ($1,782x × 700/700 × 365/365), and USP2's pro rata share of FC1's subpart F income is $218x ($218x 300/300 × 365/365).

(*3*) *Pro rata share of tested income*. Under §1.951A-1(d)(2)(i) and paragraph (e)(2)(ii) of this section, $8,018x of FC1's tested income is allocated to the common shares ($9,000x × ($9,800x/$11,000x)) and $982x of FC1's tested income is allocated to the preferred shares ($9,000x × ($1,200x/$11,000x)). Accordingly, under §1.951A-1(d)(2)(i) and paragraph (e)(2)(i) of this section, for Year 1, USP1's pro rata share of FC1's tested income is $8,018x ($8,018x × 700/700 × 365/365), and USP2's pro rata share of FC1's tested income is $982x ($982x × 300/300 × 365/365).

(x) *Example 9: Subpart F income and tested loss*—(A) *Facts*. The facts are the same as in paragraph (e)(4)(ix)(A) of this section (*Example 8*), except that for Year 1, FC1 has $8,000x of earnings and profits, $10,000x of subpart F income (without regard to the limitation in section 952(c)(1)(A)), and $2,000x of tested loss. Under section 951A(b)(2)(B)(ii) and §1.951A-6(b), the earnings and profits of FC1 are increased for purposes of section 952(c)(1)(A) by the amount of FC1's tested loss. Accordingly, after the application of section 951A(b)(2)(B)(ii) and §1.951A-6(b), the subpart F income of FC1 is $10,000x.

(B) *Analysis*—(*1*) *Pro rata share of subpart F income*. The allocable earnings and profits determined under paragraph (e)(2)(ii) of this section are $10,000x, the greater of the earnings and profits of FC1 determined under section 964 ($8,000x) or the sum of FC1's subpart F income and tested income ($10,000x + $0). The amount of FC1's allocable earnings and profits distributed in the hypothetical distribution with respect to USP2's preferred shares is $1,200x (0.04 × $100x × 300) and with respect to USP1's common shares is $8,800x ($10,000x - $1,200x). Under paragraph (e)(2)(ii) of this section, $1,200x of FC1's subpart F income is allocated to the preferred shares ($10,000x × ($1,200x/$10,000x)) and $8,800x of FC1's subpart F income is allocated to the common shares ($10,000x × ($8,800x/$10,000x)). Accordingly, under paragraph (e)(2)(i) of this section, for Year 1, USP1's pro rata share of FC1's subpart F income is $8,800x ($8,800x × 700/700 × 365/365) and USP2's pro rata share of FC1's subpart F income is $1,200x ($1,200x × 300/300 × 365/365).

(*2*) *Pro rata share of tested loss*. For purposes of paragraph (e)(2)(ii) of this section, the allocable earnings and profits determined under §1.951A-1(d)(3)(i)(B) are $2,000x, the amount of FC1's tested loss. Under §1.951A-1(d)(3)(i)(C), the entire $2,000x of tested loss is allocated in the hypothetical distribution to USP1's common shares. Accordingly, under §1.951A-1(d)(3)(i)(A) and paragraph (e)(2)(i) of this section, USP1's pro rata share of the tested loss is $2,000x.

(f) *Determination of holding period*—(1) *In general*. For purposes of sections 951 through 964, the holding period of an asset (including stock of a controlled foreign corporation) is determined by excluding the day on which the asset is acquired and including the day on which the asset is disposed of. Thus, for example, in determining the period that stock of a controlled foreign corporation is owned, the day on which the stock is directly or indirectly acquired is excluded and the day on which the stock is directly or indirectly disposed of is included.

(2) *Example: Period of stock ownership*—(i) *Facts*. On June 30 of Year 1, USP, a domestic corporation, acquires 70 of the 100 shares of the only class of stock of FC, a foreign corporation, from Individual B, a nonresident alien individual who until such time owns all 100 shares of FC. USP sells 10 shares and 60 shares of stock of FC on November 30 and December 31 of Year 1, respectively, to Individual B, a nonresident alien individual.

(ii) *Analysis*. Under paragraph (f)(1) of this section, FC is a controlled foreign corporation for the period beginning July 1 of Year 1 and extending through December 31 of Year 1. As to the 10 shares of stock sold on November 30 of Year 1, USP owns the shares from July 1 of Year 1 through November 30 of Year 1. As to the remaining 60 shares of stock, USP owns the shares beginning July 1 of Year 1 through December 31 of Year 1.

* * * * *

(h) *Definitions*. The following definitions apply for purposes of this section.

Allocable earnings and profits. The term *allocable earnings and profits* has the meaning provided in paragraph (e)(2)(ii)(A) of this section.

CFC year. The term *CFC year* means a taxable year of a foreign corporation in which the foreign corporation is a controlled foreign corporation at any time during the taxable year.

CFC year block. The term *CFC year block* has the meaning provided in paragraph (e)(2)(i)(B)(*2*) of this section.

Controlled foreign corporation. The term *controlled foreign corporation* has the meaning provided in section 957(a) (or, if applicable, section 957(b)).

Controlling section 958(a) U.S. shareholders. The term *controlling section 958(a) U.S. shareholders* has the meaning provided in paragraph (d)(2)(iii)(B) of this section.

Hypothetical distribution. The term *hypothetical distribution* has the meaning provided in paragraph (e)(2)(ii) of this section.

Own. The term *own* (or ownership or owned), when used with respect to stock of a foreign corporation, means to own the stock directly or indirectly within the meaning of section 958(a) and §1.958-1(a). *See also* §1.958-1(d) (except as provided in §1.958-1(d)(2), a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of section 958(a) for purposes of section 951 and for purposes of any provision that specifically applies by reference to section 951 or the regulations in this part under section 951, and the domestic partnership is treated as a foreign partnership under section 958(a)(2) in determining the persons that own stock of the foreign corporation within the meaning of section 958(a)).

Related persons. The term *related persons* means persons that are related within the meaning of section 267(b), as applied without regard to section 267(c)(3).

Section 958(a) U.S. shareholders. The term *section 958(a) U.S. shareholders* has the meaning provided in paragraph (d)(2)(iii)(A) of this section.

Significant ownership variance. The term *significant ownership variance* has the meaning provided in paragraph (d)(2)(ii) of this section.

Specified transfer. The term *specified transfer* has the meaning provided in paragraph (d)(2)(ii)(B) of this section.

Status change event. The term *status change event* has the meaning provided in paragraph (d)(1)(ii) of this section.

Subpart F income. The term *subpart F income* has the meaning provided in section 952.

Tested income. The term *tested income* has the meaning provided in section 951A(b)(2)(A).

Tested loss. The term *tested loss* has the meaning provided in section 951A(b)(2)(B)(i).

United States shareholder. The term *United States shareholder* has the meaning provided in paragraph (g) of this section.

(i) *Applicability date*. This section applies to taxable years of foreign corporations beginning after December 31, 2025, and to taxable years of United States shareholders for which such taxable years of those foreign corporations are relevant. For rules applicable to taxable years of foreign corporations beginning on or before December 31, 2025, and to taxable years of United States shareholders in which or with which such taxable years end, see 26 CFR 1.951-1 as contained in 26 CFR part 1 edition revised as of April 1, 2026.

Par. 5. Section 1.951-4 is added to read as follows:

§1.951-4 Transition rule for dividends.

(a) *Scope*. This section sets forth the rules for applying the transition rule for dividends in section 70354(c)(2) of Public Law 119-21, 139 Stat. 72 (July 4, 2025) (OBBBA). Paragraph (b) of this section provides the general rule for dividends subject to the transition rule. Paragraph (c) of this section provides the meaning of dividend paid or deemed paid. Paragraph (d) of this section provides the meaning of United States person subject to Federal income tax. Paragraph (e) of this section provides the meaning of taxable income. Paragraph (f) of this section provides rules for determining whether a dividend increases taxable income. Paragraph (g) of this section provides rules for the application of this section to dividends paid or deemed paid to partnerships. Paragraph (h) of this section provides certain substantiation requirements for establishing that a dividend increases the taxable income of a United States person subject to Federal income tax. Paragraph (i) of this section provides the applicability date for this section.

(b) *Transition rule.* For purposes of this section, the term *transition rule* means the rule provided in section 70354(c)(2) of the OBBBA and this paragraph (b). Under the transition rule, for purposes of applying section 951(a)(2)(B), as in effect before amendment by the OBBBA, a dividend paid or deemed paid by a controlled foreign corporation with respect to stock of the controlled foreign corporation is not treated as a dividend to the extent that—

(1) Either—

(i) The dividend was paid or deemed paid on or before June 28, 2025, during the controlled foreign corporation's taxable year that includes June 28, 2025, and the United States shareholder that owned (within the meaning of section 958(a)) that stock on the last day of that taxable year did not own (within the meaning of section 958(a)) that stock during the portion of the taxable year ending on June 28, 2025; or

(ii) The dividend was paid or deemed paid after June 28, 2025, and before the controlled foreign corporation's first taxable year beginning after December 31, 2025; and

(2) The dividend does not increase the taxable income of a United States person subject to Federal income tax.

(c) *Dividend paid or deemed paid*. For purposes of this section, any amount that would be treated, without regard to this section, as a distribution received by a person as a dividend under section 951(a)(2)(B), as in effect before the amendments to section 951(a) made by the OBBBA, is treated as a dividend paid or deemed paid.

(d) *United States person subject to Federal income tax*. For purposes of this section, a United States person subject to Federal income tax means—

(1) Any United States person (as defined in section 7701(a)(30)), except for a domestic partnership, an S corporation (as defined in section 1361), a trust that is a United States person described in section 7701(a)(30)(E) and treated as owned by a person under sections 671 through 678, or a bona fide resident (as defined in section 937(a)) of Guam, the Commonwealth of the Northern Mariana Islands, or the U.S. Virgin Islands; and

(2) Any nonresident alien individual who elects to be treated as a resident of the United States under section 6013(g) or (h).

(e) *Meaning of taxable income*—(1) *In general*. Except as provided in paragraph (e)(2) of this section, for purposes of this section, taxable income means taxable income as defined in section 63.

(2) *Exceptions*—(i) *Regulated investment companies*. In the case of a regulated investment company (RIC) (as defined in section 851) that satisfies the requirements of section 852(a) for a taxable year in which the RIC receives, or is deemed to receive, a dividend described in paragraph (b)(1) of this section, taxable income means investment company taxable income (as defined in section 852(b)).

(ii) *Real estate investment trusts.* In the case of a real estate investment trust (REIT) (as defined in section 856) that satisfies the requirements of section 857(a) for a taxable year in which the REIT receives, or is deemed to receive, a dividend described in paragraph (b)(1) of this section, taxable income means real estate investment trust taxable income (as defined in section 857(b)(2)).

(iii) *Exempt organizations*. In the case of an organization exempt from taxation under section 501(a), taxable income means unrelated business taxable income (as defined in section 512).

(f) *Determining whether a dividend increases taxable income*—(1) *In general*. For purposes of determining whether a dividend paid or deemed paid increases the taxable income of a United States person subject to Federal income tax, all applicable provisions of the Internal Revenue Code, and the regulations thereunder, are applied before applying, and without regard to, the transition rule. Therefore, the determination of whether a dividend paid or deemed paid increases the taxable income of a United States person subject to Federal income tax is made after the application of any exclusion that results in the dividend not being included in the person's gross income or taxable income and any dividends received deduction that reduces the amount of the dividend included in the person's taxable income.

(2) *Section 245A coordination example.* The following example illustrates the

application of the rule in paragraph (f)(1) of this section.

(i) *Facts.* US1, a domestic corporation that is not a RIC, REIT, S corporation, or organization exempt from taxation under section 501(a), owns all the stock of CFC, a foreign corporation. On March 1, 2025, CFC pays a dividend of $100x to US1, which, absent the application of §1.245A-5(b), qualifies for the deduction under section 245A(a). On July 1, 2025, USP1 sells all its stock of CFC to US2, a domestic corporation, which results in an extraordinary reduction with respect to US1's ownership of CFC, within the meaning of §1.245A-5(e)(1). If §1.245A-5 were applied before and without regard to the transition rule, US1's pre-reduction pro rata share under §1.245A-5(e)(2)(ii) would be $100x and the entire dividend of $100x to US1 would be an extraordinary reduction amount with respect to US1, within the meaning of §1.245A-5(e)(1). Additionally, the ineligible amount with respect to US1 within the meaning of §1.245A-5(b)(2), would be $100x. US1, US2, and CFC all use a calendar taxable year. US1's reporting for Federal income tax purposes is consistent with §1.245A-5(e).

(ii) *Analysis*. Under paragraph (f)(1) of this section, the determination of whether the dividend of $100x increases the taxable income of US1, a United States person subject to Federal income tax, is made after the application of any exclusion that results in the dividend not being included in the person's gross income or taxable income and any dividends received deduction that reduces the amount of the dividend included in the person's taxable income. Additionally, in determining US1's pre-reduction pro rata share under §1.245A-5(e)(2)(ii), any decrease for amounts taken into account by a U.S. tax resident under §1.245A-5(e)(2)(ii)(B) is determined by applying section 951(a)(2)(B), as in effect before amendment by the OBBBA, without regard to the transition rule. Therefore, because the ineligible amount with respect to US1 and the dividend paid to US1 would be $100x before applying, and without regard to, the transition rule, the ineligible amount is $100x and none of the dividend paid to US1 is eligible for a section 245A deduction after applying §1.245A-5(b). Accordingly, the entire dividend of $100x is treated as increasing the taxable income of a United States person subject to Federal income tax for purposes of this section. Additionally, the election to close CFC's taxable year pursuant to §1.245A-5(e)(3)(i)(A) is available to US1, provided the other conditions described in §1.245A-5(e)(3)(i)(A) are met.

(3) *Generally applicable deductions.* The determination of the amount by which a dividend paid or deemed paid increases the taxable income of a United States person subject to Federal income tax is made without regard to decreases to taxable income resulting from generally applicable deductions of the United States person that are not particular to the receipt of a dividend, including deductions for—

(i) Depreciation under section 167;

(ii) Net operating losses under section 172;

(iii) Distributions under sections 651 and 661; and

(iv) Dividends paid under sections 852(b)(2)(D) and 857(b)(2)(B).

(4) *Dividends paid to controlled foreign corporations*—(i) *In general*. In the case of a dividend paid or deemed paid by a controlled foreign corporation to another controlled foreign corporation, for purposes of this section, the dividend is treated as increasing the taxable income of a United States person subject to Federal income tax to the extent the dividend is taken into account in determining a United States shareholder's inclusion under section 951(a)(1)(A) or 951A(a).

(ii) *Inclusions under section 951(a)(1)(A).* For purposes of this paragraph (f)(4), a dividend is taken into account in determining a United States shareholder's inclusion under section 951(a)(1)(A) if the dividend would give rise to an amount includible in gross income by the United States shareholder under section 951(a)(1)(A), determined without regard to properly allocable deductions of the controlled foreign corporation that received or is deemed to receive the dividend (except as provided in paragraph (f)(4)(iv) of this section), the current earnings and profits limitation under section 952(c)(1)(A), qualified deficits under section 952(c)(1)(B), or chain deficits under section 952(c)(1)(A).

(iii) *Inclusions under section 951A(a).* For purposes of this paragraph (f)(4), a dividend is taken into account in determining a United States shareholder's inclusion under section 951A(a) if the dividend would give rise to an amount includible in gross income by the United States shareholder under section 951A, determined without regard to properly allocable deductions of the controlled foreign corporation that received or is deemed to receive the dividend (except as provided in paragraph (f)(4)(iv) of this section), tested losses (as defined in section 951A(c)(2)(B) before amendment by the OBBBA) of any other controlled foreign corporation, or the net deemed tangible income return of the United States shareholder (as defined in section 951A(b)(2) before amendment by the OBBBA).

(iv) *High-taxed amounts.* For purposes of this paragraph (f)(4), any dividend paid or deemed paid to a controlled foreign corporation that is excluded from the controlled foreign corporation's subpart F income or tested income under the high-tax exception or the high-tax exclusion (see section 954(b)(4) and §1.951A-2(c)(1)(iii)), is treated as not taken into account in determining a United States shareholder's inclusion under section 951(a)(1)(A) or 951A(a).

(g) *Application to partnerships*—(1) *In general.* In the case of a dividend paid or deemed paid to a partnership, the determination of whether the dividend increases the taxable income of a United States person subject to Federal income tax is made by reference to the partners of the partnership. Further, to the extent the dividend is included in the distributive share of a partner that is itself a partnership, the determination of whether the dividend increases the taxable income of a United States person subject to Federal income tax is made by reference to the partners of that partnership.

(2) *Safe harbor for publicly held partnership interests*—(i) *In general*. To the extent a dividend paid or deemed paid by a controlled foreign corporation is allocated to a de minimis owner by reason of owning an interest in a class of publicly held interests in a domestic partnership, the dividend is treated as increasing the taxable income of a United States person subject to Federal income tax.

(ii) *Exception.* Paragraph (g)(2)(i) of this section does not apply if the domestic partnership has actual knowledge of facts that allow the partnership to determine that the de minimis owner is not a United States person subject to Federal income tax within the meaning of paragraph (d) of this section or that the dividend paid by the controlled foreign corporation does not increase the de minimis owner's taxable income within the meaning of paragraphs (e) and (f) of this section.

(iii) *Meaning of de minimis owner.* For purposes of this paragraph (g)(2), the term *de minimis owner* means any person that owns no more than 5 percent of a class of publicly held interests in a domestic partnership on each day of the taxable year of the domestic partnership. In determining whether a person is a de minimis owner, a person is treated as owning an interest in a class of publicly held interests if the person owns the interest directly or by applying the rules of section 318(a), except that section 318(a)(2)(C) and (a)(3)(C) are applied for this purpose by substituting "5 percent" for "50 percent."

(iv) *Meaning of publicly held interest.* For purposes of this paragraph (g)(2), *publicly held interest* means any class of interests in a domestic partnership that is regularly traded on an established securities market as defined in §1.7704-1(b), but without regard to §1.7704-1(b)(3).

(h) *Establishing extent to which a dividend increases taxable income of a United States person subject to Federal income tax*. A United States shareholder that claims a reduction of its pro rata share of subpart F income or tested income under section 951(a)(2)(B), as a result of a dividend that is described in paragraph (b)(1) of this section, must substantiate such claim by attaching to Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations* (or successors), a statement titled "Pro Rata Share Transition Rule Statement" that—

(1) Provides the amount of each dividend paid by the controlled foreign corporation (with respect to the stock owned by the United States shareholder filing the return) that is described in paragraph (b)(1) of this section but treated as a dividend for purposes of applying section 951(a)(2)(B),

(2) Describes why the United States shareholder filing the return is entitled to treat each such amount as a dividend for purposes of section 951(a)(2)(B), and

(3) Describes how the United States shareholder determined such amount increased the taxable income of a United States person subject to Federal income tax under the rules of this section.

(i) *Applicability date*. This section applies to taxable years of a foreign corporation that either include June 28, 2025, or begin after June 28, 2025, and before the foreign corporation's first taxable year beginning after December 31, 2025.

Par. 6. Section 1.951A-1 is amended by:

1. Revising paragraphs (a)(2) through (e); and

2. Removing paragraph (f).

The revisions read as follows:

§1.951A-1 General provisions.

(a) * * *

(2) *Scope.* Paragraph (b) of this section provides the general rule requiring a United States shareholder to include in gross income its net CFC tested income for a U.S. shareholder inclusion year. Paragraph (c) of this section provides rules for determining the amount of a United States shareholder's net CFC tested income for the U.S. shareholder inclusion year, including a rule for the application of section 951A and the section 951A regulations to consolidated groups. Paragraph (d) of this section provides rules for determining a United States shareholder's pro rata share of tested income and tested loss for purposes of determining the United States shareholder's net CFC tested income. Paragraph (e) of this section provides additional definitions for purposes of this section and the section 951A regulations. For rules applying this section to foreign controlled United States shareholders and foreign controlled foreign corporations, see section 951B (generally treating references in this section to the term "United States shareholder" as including the term "foreign controlled United States shareholder" and the term "controlled foreign corporation" as including the term "foreign controlled foreign corporation").

(b) *Inclusion of net CFC tested income*. Each person who is a United States shareholder of any controlled foreign corporation and owns stock of any such controlled foreign corporation includes in gross income in the U.S. shareholder inclusion year the shareholder's net CFC tested income inclusion amount, if any, for the U.S. shareholder inclusion year.

(c) *Determination of net CFC tested income inclusion amount*—(1) *In general*. Except as provided in paragraph (c)(2) of this section, the term net CFC tested income inclusion amount means, with respect to a United States shareholder and a U.S. shareholder inclusion year, the excess (if any) of—

(i) The aggregate of the shareholder's pro rata share of the tested income of each tested income CFC (as defined in §1.951A-2(b)(1)) for a CFC inclusion year, over

(ii) The aggregate of the shareholder's pro rata share of the tested loss of each tested loss CFC (as defined in §1.951A-2(b)(2)) for a CFC inclusion year.

(2) [Reserved]

(d) *Determination of pro rata share*—(1) *In general*. For purposes of paragraph (c)(1) of this section, each United States shareholder that owns stock of a controlled foreign corporation on any day during a CFC inclusion year determines its pro rata share (if any) of tested income or tested loss of the controlled foreign corporation for the U.S. shareholder inclusion year that includes the last day on which the United States shareholder owns stock in the controlled foreign corporation during the CFC inclusion year. In no case may the sum of the pro rata share of tested income or tested loss of a controlled foreign corporation for a CFC inclusion year allocated to stock under this paragraph (d) exceed the amount of the tested income or tested loss of the controlled foreign corporation for the CFC inclusion year. Except as modified in this paragraph (d), a United States shareholder's pro rata share of tested income or tested loss is determined under the rules of section 951(a)(2) and §1.951-1(b) and (e) in the same manner as those provisions apply to subpart F income. *See also* §1.951-1(d), which requires or permits the closing of the taxable year of a foreign corporation in specified circumstances. Under section 951(a)(2) and §1.951-1(b) and (e), as modified by this paragraph (d), a United States shareholder's pro rata share of tested income or tested loss for a U.S.

shareholder inclusion year is determined with respect to the stock of the controlled foreign corporation owned by the U.S. shareholder during a CFC inclusion year. A United States shareholder's pro rata share of tested income or tested loss is translated into United States dollars using the average exchange rate for the CFC inclusion year of the controlled foreign corporation. Paragraphs (d)(2) and (3) of this section provide rules for determining a United States shareholder's pro rata share of tested income or tested loss of a controlled foreign corporation.

(2) *Tested income*—(i) *In general*. Except as provided in paragraph (d)(2)(ii) of this section, a United States shareholder's pro rata share of the tested income of each tested income CFC for a U.S. shareholder inclusion year is determined under section 951(a)(2) and §1.951-1(b) and (e), substituting "tested income" for "subpart F income" each place it appears, other than in §1.951-1(e)(2)(ii)(A).

(ii) *Special rule for prior allocation of tested loss*. In any case in which tested loss has been allocated to any class of stock in a prior CFC inclusion year under paragraph (d)(3)(iii) of this section (or under §1.951A-1(d)(4)(iii), as contained in 26 CFR part 1 edition revised as of April 1, 2026), tested income is first allocated to each such class of stock in the order of its liquidation priority to the extent of the excess (if any) of the sum of the tested loss allocated to each such class of stock for each prior CFC inclusion year under paragraph (d)(3)(iii) of this section (or under §1.951A-1(d)(4)(iii), as contained in 26 CFR part 1 edition revised as of April 1, 2026), over the sum of the tested income allocated to each such class of stock for each prior CFC inclusion year under this paragraph (d)(2)(ii). Paragraph (d)(2)(i) of this section applies for purposes of determining a United States shareholder's pro rata share of the remainder of the tested income, except that, for purposes of the hypothetical distribution in §1.951-1(e)(2)(ii), the amount of allocable earnings and profits of the tested income CFC is reduced by the amount of tested income allocated under the first sentence of this paragraph (d)(2)(ii). For an example of the application of this paragraph (d)(2), see paragraph (d)(3)(iv)(B) of this section (*Example 2*).

(iii) *Examples*. The following examples illustrate the application of paragraph (d)(2) of this section. *See also* §1.951-1(e)(4)(ix) (*Example 8*) (illustrating a United States shareholder's pro rata share of tested income).

(A) *Example 1*—(*1*) *Facts*. FS, a controlled foreign corporation, has outstanding 70 shares of common stock and 30 shares of 4% nonparticipating, cumulative preferred stock with a par value of $10x per share. P Corp, a domestic corporation and a United States shareholder of FS, owns all of the common shares. Individual A, a United States citizen and a United States shareholder of FS, owns all of the preferred shares. Individual A, FS, and P Corp use the calendar year as their taxable year. Individual A and P Corp are shareholders of FS for all of Year 1. At the beginning of Year 1, FS had no dividend arrearages with respect to its preferred stock. For Year 1, FS has $100x of earnings and profits, $120x of tested income, and no subpart F income within the meaning of section 952.

(*2*) *Analysis—Determination of pro rata share of tested income*. For purposes of determining P Corp's pro rata share of FS's tested income under this paragraph (d)(2) the amount of FS's allocable earnings and profits for purposes of the hypothetical distribution described in §1.951-1(e)(2)(ii) is $120x, the greater of its earnings and profits as determined under section 964 ($100x) and the sum of its subpart F income and tested income ($0 + $120x). Under this paragraph (d)(2) and §1.951-1(e)(2)(ii), the amount of FS's allocable earnings and profits distributed in the hypothetical distribution with respect to the preferred shares of FS is $12x (0.04 × $10x × 30) and the amount distributed with respect to the common shares of FS is $108x ($120x - $12x), which results in $12x of tested income being allocated to the preferred shares and $108x being allocated to the common shares. Accordingly, under this paragraph (d)(2) and §1.951-1(e)(2), Individual A's pro rata share of FS's tested income is $12x, and P Corp's pro rata share of FS's tested income is $108x for Year 1.

(B) *Example 2*—(*1*) *Facts*. P Corp, a domestic corporation and a United States shareholder, owns all 100 shares of the only class of stock of FS, a controlled foreign corporation, from January 1 of Year 1, until May 26 of Year 1. On May 26 of Year 1, P Corp sells all its FS stock to R Corp, a domestic corporation that is not related to P Corp, and recognizes no gain or loss on the sale. P Corp does not make an election to close the taxable year of FS under §1.951-1(d)(2). R Corp, a United States shareholder of FS, owns the stock of FS from May 27 through December 31 of Year 1. For Year 1, FS has $50x of earnings and profits, $50x of tested income, and no subpart F income within the meaning of section 952. P Corp, R Corp, and FS all use the calendar year as their taxable year, and Year 1 has 365 days.

(*2*) *Analysis—Determination of pro rata share of tested income*. Under this paragraph (d)(2) and §1.951-1(e)(2)(i), P Corp's pro rata share of the tested income of FS is $20x, which is equal to $50x of tested income multiplied by the product of two fractions. For the first fraction, the numerator is the number of shares P Corp owned (100) and the denominator is the number of shares of FS outstanding (100) (100 percent). For the second fraction, the numerator is the number of days in Year 1 that P Corp owned the shares while P Corp was a United States shareholder of FS and FS was a CFC (146) and the denominator is the number of days in the CFC inclusion year of FS (365) (40 percent). R Corp's pro rata share of the tested income of FS is $30x, which is equal to $50x of tested income multiplied by the product of two fractions. For the first fraction, the numerator is the number of shares R Corp owned (100) and the denominator is the number of shares of FS outstanding (100) (100 percent). For the second fraction, the numerator is the number of days in Year 1 that R Corp owned the shares while R Corp was a United States shareholder of FS and FS was a CFC (219) and the denominator is the number of days in the CFC inclusion year of FS (365) (60 percent).

(3) *Tested loss*—(i) *In general*. A United States shareholder's pro rata share of the tested loss of each tested loss CFC for a U.S. shareholder inclusion year is determined under section 951(a)(2) and §1.951-1(b) and (e) with the following modifications—

(A) "Tested loss" is substituted for "subpart F income" each place it appears;

(B) For purposes of the hypothetical distribution described in §1.951-1(e)(2)(ii), the amount of allocable earnings and profits of a controlled foreign corporation for a CFC inclusion year is treated as being equal to the tested loss of the tested loss CFC for the CFC inclusion year; and

(C) Except as provided in paragraphs (d)(3)(ii) and (iii) of this section, the hypothetical distribution described in §1.951-1(e)(2)(ii) is treated as made solely with respect to the common stock of the tested loss CFC.

(ii) *Special rule in case of accrued but unpaid dividends*. If a tested loss CFC's earnings and profits that have accumulated since the issuance of preferred shares are reduced below the amount necessary to satisfy any accrued but unpaid dividends with respect to such preferred shares, then the amount by which the tested loss reduces the earnings and profits below the amount necessary to satisfy the accrued but unpaid dividends is allocated in the hypothetical distribution described in §1.951-1(e)(2)(ii) to the preferred stock of the tested loss CFC and the remainder of the tested loss is allocated in the hypothetical distribution to the common stock of the tested loss CFC.

(iii) *Special rule for stock with no liquidation value*. If a tested loss CFC's common stock has a liquidation value of zero and there is at least one other class of equity with a liquidation preference relative to the common stock, then the tested loss is allocated in the hypothetical distribution described in §1.951-1(e)(2)(ii) to the most junior class of equity with a positive liquidation value to the extent of such liquidation value. Thereafter, tested loss is allocated to the next most junior class of equity to the extent of its liquidation value and so on. All determinations of liquidation value are to be made as of the beginning of the CFC inclusion year of the tested loss CFC.

(iv) *Examples*. The following examples illustrate the application of this paragraph (d)(3). *See also* §1.951-1(e)(4)(x) (*Example 9*) (illustrating a United States shareholder's pro rata share of subpart F income and tested loss).

(A) *Example 1*—(*1*) *Facts*. FS, a controlled foreign corporation, has outstanding 70 shares of common stock and 30 shares of 4% nonparticipating, cumulative preferred stock with a par value of $10x per share. P Corp, a domestic corporation and a United States shareholder of FS, owns all the common shares. Individual A, a United States citizen and a United States shareholder, owns all the preferred shares. FS, Individual A, and P Corp all use the calendar year as their taxable year. Individual A and P Corp are shareholders of FS for all of Year 5. At the beginning of Year 5, FS had earnings and profits of $120x, which accumulated after the issuance of the preferred stock. At the end of Year 5, the accrued but unpaid dividends with respect to the preferred stock are $36x. For Year 5, FS has a $100x tested loss, and no other items of income, gain, deduction or loss. At the end of Year 5, FS has earnings and profits of $20x.

(*2*) *Analysis*. FS is a tested loss CFC for Year 5. Before taking into account the tested loss in Year 5, FS had sufficient earnings and profits to satisfy the accrued but unpaid dividends of $36x. The amount of the reduction in earnings below the amount necessary to satisfy the accrued but unpaid dividends attributable to the tested loss is $16x ($36x - ($120x - $100x)). Accordingly, under paragraph (d)(3)(ii) of this section, $16x of the tested loss is allocated to the preferred stock of FS in the hypothetical distribution described in §1.951-1(e)(2)(ii), and $84x ($100x - $16x) of the tested loss is allocated to the common shares of FS in the hypothetical distribution.

(B) *Example 2*—(*1*) *Facts*. FS, a controlled foreign corporation, has outstanding 100 shares of common stock and 50 shares of 4% nonparticipating, cumulative preferred stock with a par value of $100x per share. P Corp, a domestic corporation and a United States shareholder of FS, owns all the common shares. Individual A, a United States citizen and a United States shareholder, owns all the preferred shares. FS, Individual A, and P Corp all use the calendar year as their taxable year. Individual A and P Corp are shareholders of FS for all of Year 1 and Year 2. At the beginning of Year 1, the common stock has no liquidation value and the preferred stock has a liquidation value of $5,000x and no accrued but unpaid dividends. In Year 1, FS has a tested loss of $1,000x and no other items of income, gain, deduction, or loss. In Year 2, FS has tested income of $3,000x and no other items of income, gain, deduction, or loss. FS has earnings and profits of $3,000x for Year 2. At the end of Year 2, FS has accrued but unpaid dividends of $400x with respect to the preferred stock, the sum of $200x for Year 1 (0.04 × $100x × 50) and $200x for Year 2 (0.04 × $100x × 50).

(*2*) *Analysis*—(*i*) *Year 1*. FS is a tested loss CFC in Year 1. The common stock of FS has a liquidation value of zero, and the preferred stock has a liquidation preference relative to the common stock. The tested loss ($1,000x) does not exceed the liquidation value of the preferred stock ($5,000x). Accordingly, under paragraph (d)(3)(iii) of this section, the tested loss is allocated to the preferred stock in the hypothetical distribution described in §1.951-1(e)(2)(ii). Individual A's pro rata share of the tested loss is $1,000x, and P Corp's pro rata share of the tested loss is $0.

(*ii*) *Year 2*. FS is a tested income CFC in Year 2. Because $1,000x of tested loss was allocated to the preferred stock in Year 1 under paragraph (d)(3)(iii) of this section, the first $1,000x of tested income in Year 2 is allocated to the preferred stock under paragraph (d)(2)(ii) of this section. P Corp's and Individual A's pro rata shares of the remaining $2,000x of tested income are determined under the general rule of paragraph (d)(2)(i) of this section, except that for purposes of the hypothetical distribution the amount of FS's allocable earnings and profits is reduced by the tested income allocated under paragraph (d)(2)(ii) of this section to $2,000x ($3,000x - $1,000x). Accordingly, under paragraph (d)(2)(i) of this section and §1.951-1(e)(2)(ii), the amount of FS's allocable earnings and profits distributed in the hypothetical distribution with respect to the preferred stock of FS is $400x ($400x of accrued but unpaid dividends) and with respect to the common stock of FS is $1,600x ($2,000x - $400x), which results in $400x of tested income being allocated to the preferred stock and $1,600x of tested income being allocated to the common stock. Under paragraph (d)(2)(i) of this section and §1.951-1(e)(2)(i), Individual A's pro rata share of the tested income is $1,400x ($1,000x + $400x), and P Corp's pro rata share of the tested income is $1,600x.

(e) *Definitions*. This paragraph (e) provides additional definitions that apply for purposes of this section and the section 951A regulations. Other definitions relevant to the section 951A regulations are included in §§1.951A-2 through 1.951A-4.

(1) *CFC inclusion year*. The term *CFC inclusion year* means a taxable year of a foreign corporation in which the foreign corporation is a controlled foreign corporation at any time during the taxable year.

(2) *Controlled foreign corporation*. The term *controlled foreign corporation* has the meaning provided in section 957(a).

(3) *Own*. The term *own* (or ownership or owned), when used with respect to stock of a foreign corporation, means to own the stock directly or indirectly within the meaning of section 958(a) and §1.958-1(a). *See also* §1.958-1(d) (except as provided in §1.958-1(d)(2), a domestic partnership is not treated as owning stock of a foreign corporation within the meaning of section 958(a) for purposes of section 951A and for purposes of any provision that specifically applies by reference to section 951A or the section 951A regulations, and the domestic partnership is treated as a foreign partnership under section 958(a)(2) in determining the persons that own stock of the foreign corporation within the meaning of section 958(a)).

(4) *United States shareholder*. The term *United States shareholder* has the meaning set forth in section 951(b).

(5) *U.S. shareholder inclusion year*. The term *U.S. shareholder inclusion year* means a United States shareholder's taxable year that includes the last day on which the United States shareholder owns stock in a controlled foreign corporation during a CFC inclusion year of the controlled foreign corporation.

Par. 7. Section 1.951A-7 is amended by:

1. Revising paragraph (a); and
2. Adding paragraph (c).

The revision and addition read as follows:

§1.951A-7 Applicability dates.

(a) *In general*. Except as otherwise provided in this section, §1.951A-1 applies to taxable years of foreign corporations beginning after December 31, 2025, and to taxable years of United States shareholders for which such taxable years of those foreign corporations are relevant. For rules applicable to taxable years of foreign corporations beginning on or before such date, and to taxable years of United States shareholders in which or with which such taxable years end, see 26 CFR 1.951A-1 as contained in 26 CFR part 1 edition revised as of April 1, 2026. Except as otherwise provided in this section, §§ 1.951A-2 through 1.951A-6 apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

* * * * *

(c) *Transition rule for global intangible low-taxed income*. In the case of a taxable year of a foreign corporation beginning after December 31, 2025, that ends with or within a taxable year of a United States shareholder beginning on or before December 31, 2025, 26 CFR 1.951A-1 as contained in 26 CFR part 1 edition revised as of April 1, 2026 applies with respect to such United States shareholder, taking into account the amendments to section 951(a)(2) made by section 70354(a) of Public Law 119-21, 139 Stat. 72 (July 4, 2025) when determining the United States shareholder's pro rata share of any tested item.

Par. 8. Section 1.1502-80 is amended by revising paragraph (j)(3) to read as follows:

§1.1502-80 Applicability of other provisions of law.

* * * * *

(j) * * *

(3) *Applicability date*. This paragraph (j) applies to consolidated return years—

(i) For which the original consolidated return is due (without extensions) after February 23, 2023; and

(ii) That include the last day of a taxable year beginning before January 1, 2026, of a controlled foreign corporation owned by a member of the consolidated group.

Par. 9. Section 1.6038-2 is amended by revising paragraphs (f) and (m) to read as follows:

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations.

* * * * *

(f) *Contents of return*. Returns on Form 5471 (or successor form) must contain information prescribed by Form 5471 (or successor form). Such information may include (but is not limited to) the following:

* * * * *

(8) With respect to the outstanding stock of the foreign corporation—

(i) A description of each class of stock,

(ii) The first day of the foreign corporation's annual accounting period and the number of shares of each class of stock outstanding on the first day of the annual accounting period,

(iii) The date and a description of any issuance, redemption, or any other change to the number of shares of any class of stock during the annual accounting period, including the number of shares issued, redeemed, or otherwise changed,

(iv) The balance of each class of stock outstanding during the annual accounting period immediately following any such issuance, redemption, or other change, and

(v) For each person that directly owns (within the meaning of section 958(a)) stock in the foreign corporation and each United States shareholder (as defined in section 951(b), taking into account section 953(c)) that indirectly owns (as described in section 958(a)(2) and determined by treating a domestic partnership in the same manner as a foreign partnership pursuant to §1.958-1(d)) stock in the foreign corporation, at any time during the annual accounting period:

(A) A description of each class of stock held by each such person (in the case of direct owners) or indirectly owned by each such person (in the case of United States shareholders) at any time during the annual accounting period,

(B) The number of shares of each class of stock held on the first day of the annual accounting period by each such person (in the case of direct owners) or indirectly owned on the first day of the annual accounting period by each such person (in the case of United States shareholders),

(C) The date and a description of any acquisition, receipt, redemption, disposition, or any other change to the number of any shares of stock held by each such person (in the case of direct owners) or indirectly owned by each such person (in the case of United States shareholders) at any time during the annual accounting period, including the number of shares acquired, received, redeemed, disposed, or otherwise changed, and

(D) The balance of each class of stock held by each such person (in the case of direct owners) or indirectly owned by each such person (in the case of United States shareholders) during the annual accounting period immediately following any such acquisition, receipt, redemption, disposition, or other change.

* * * * *

(m) *Applicability dates*. This section applies to taxable years of foreign corporations beginning after December 31, 2025. For rules applicable to taxable years of foreign corporations beginning on or before such date, see 26 CFR 1.6038-2 as contained in 26 CFR part 1 edition revised as of April 1, 2026.

Frank J. Bisignano,
Chief Executive Officer.

(Filed by the Office of the Federal Register August 25, 2026, 8:45 a.m., and published in the issue of the Federal Register for August 26, 2026, 91 FR 55037)

Notice of Proposed Rulemaking

Racial Nondiscrimination in Private Schools

REG-119986-25

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would update existing regulations to provide that a private school is not described as an organization exempt from Federal income tax if it discriminates on the basis of race, color, or national or ethnic origin in administration of its educational, admissions, scholarship, athletic, or other policies, based on the fundamental public policy of the United States against such practices. These proposed regulations would affect private schools in taxable years beginning after May 31, 2027, which is after the final regulations are expected to be published.

DATES: Written or electronic comments and requests for a public hearing must be received by November 3, 2026.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically via the Federal eRulemaking Portal at *https://www.regulations.gov* (indicate IRS and REG-119986-25) by following the online instructions for submitting comments. In accordance with 5 U.S.C. 553(b)(4), a plain language summary of these proposed regulations is also available on the Federal eRulemaking Portal. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section. 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 to the IRS's public docket. Send paper submissions to: CC:PA:01:PR (REG-119986-25), Room 5503, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) at (202) 317-6000 (not a toll-free number); concerning submission of comments or requests for a public hearing, the Publications and Regulations Section at (202) 317-6901 (not a toll-free number) or by email at *publichearings@irs.gov* (preferred).

SUPPLEMENTARY INFORMATION:

Authority

This notice of proposed rulemaking contains proposed amendments to the Income Tax Regulations (26 CFR part 1) that would add a new §1.501(c)(3)-2 issued under section 501(c)(3) of the Internal Revenue Code (Code).

These proposed regulations are issued pursuant to section 7805(a) of the Code, which authorizes the Secretary of the Treasury or the Secretary's delegate to "prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."

Background

I. *Statute and applicable regulations*

Section 501(c)(3) describes, in part, organizations that are organized and operated exclusively for "charitable … or educational purposes" provided certain restrictions on private inurement, lobbying, and intervention in political campaigns are not violated. Such organizations are generally exempt from Federal income tax by section 501(a). Section 170 of the Code provides, in part, a deduction to taxpayers who make "charitable contributions" to organizations specified in section 170(c)(2), which essentially mirrors the description of organizations satisfying the requirements of section 501(c)(3). In determining the amount of a taxpayer's deduction allowed under section 170(a) within the taxable year, section 170(b)(1)(A)(ii) includes any charitable contribution to an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. Section 1.170A-9(c)(1) provides that an "educational organization" is described in section 170(b)(1)(A)(ii) if its primary function is the presentation of formal instruction and it normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. The term includes institutions such as primary, secondary, preparatory, or high schools, and colleges and universities. It includes Federal, State, and other public-supported schools that otherwise come within the definition.

Sections 170(c)(2), 170(b)(1)(A)(ii), and 501(c)(3) do not further define the terms "charitable" or "educational" or explain what it means to be organized and operated exclusively for such purposes.

For over 65 years, however, the provisions of §1.501(c)(3)-1 have provided guidance on the interpretation of the terms "charitable" and "educational" as used in section 501(c)(3). Section 1.501(c)(3)-1(a) provides that, in order to be exempt under section 501(a) as an organization described in section 501(c)(3), the organization must be both organized and operated exclusively for one or more of the purposes specified in section 501(c)(3), as defined and elaborated in §1.501(c)(3)-1(d). Thus, an organization that fails to meet either the "organizational test" set forth in §1.501(c)(3)-1(b) or the "operational test" set forth in §1.501(c)(3)-1(c) is not exempt from Federal income tax.

Section 1.501(c)(3)-1(d)(1) provides a list of purposes that would allow an organization to be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the exempt purposes specified in section 501(c)(3), which list includes charitable and educational purposes. Section 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes that may fall within the broad outlines of "charity" as developed by judicial decisions. In addition, §1.501(c)(3)-1(d)(2)(ii) states that the term includes the "promotion of social welfare by organizations designed to … eliminate prejudice and discrimination."

Similar to the description of an educational organization in section 170(b)(1)(A)(ii), §1.501(c)(3)-1(d)(3)(ii), (*Example 1*), provides that a primary or secondary school, a college, or a professional or trade school, that has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on may qualify for exemption as an educational organization of the character contemplated by section 501(c)(3) if it otherwise meets the requirements of section 501(c)(3).

II. *Policy of the United States against racial discrimination in education*

On May 17, 1954, the Supreme Court of the United States decided *Brown v. Board of Education of Topeka, Kansas*, 347 U.S. 483 (1954), in which the Court held that state-sanctioned racial segregation of public schools violates the Equal Protection Clause of the Fourteenth Amendment. One year later, the Court reiterated that "full compliance" with *Brown* required public schools to admit the students that had sued "on a racially nondiscriminatory basis." *Brown v. Board of Education*, 349 U.S. 294, 300–301 (1955).

Enacted into law on July 2, 1964, Title VI of the Civil Rights Act of 1964 states, in relevant part, "No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance."

In 1976, the Supreme Court decided the case of *Runyon v. McCrary*, 427 U.S. 160, holding that 42 U.S.C. 1981 (Section 1981)[1] bars a private school from discriminating against applicants based on their race. The same year, the Supreme Court confirmed that the protections of Section 1981 apply equally to all persons regardless of race. *McDonald v. Santa Fe Trail Transp. Co.*, 427 U.S. 273, 295 (1976).

On June 30, 1971, the United States District Court for the District of Columbia entered an order permanently enjoining the Treasury Department and the IRS from recognizing as described in section 501(c)(3) any private school located in the State of Mississippi that failed to adopt, publish, and operate under a racially nondiscriminatory policy as to students and that failed to supply the IRS with certain information to ensure operation on a nondiscriminatory basis. *Green v. Connally*, 330 F. Supp. 1150 (D.D.C. 1971), *aff'd sub nom.*, *Coit v. Green*, 404 U.S. 997 (1971). The court stated that "[t]he Code must be construed and applied in consonance with the Federal public policy against support for racial segregation of schools, public or private." *Id*. at 1163. The court declared that section 501(c)(3) "does not provide a tax exemption for ...any organization that is operated for educational purposes unless the school or other educational institution involved has a racially nondiscriminatory policy as to students." *Id*. at 1179. It further declared that this requires that "the school or other educational institution admits the students of any race to all the rights, privileges, programs and activities generally accorded or made available to students at that school, and which includes, specifically but not exclusively, a policy of making no discrimination on the basis of race in administration of educational policies, applications for admission, of scholarship and loan programs, and athletic and extra-curricular programs." *Id*.

That year, the IRS issued Rev. Rul. 71-447, 1971-2 C.B. 230, which states that a private school that does not have a racially nondiscriminatory policy as to students does not qualify for exemption from Federal income tax. Consistent with *Green v. Connally*, the revenue ruling defines a "racially nondiscriminatory policy as to students" as meaning that the school admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs. In support, the revenue ruling states, "All charitable trusts, educational or otherwise, are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy," citing to common law concepts of charity and the Restatement of Trusts.[2] The revenue ruling acknowledges that Federal statutory law does not prohibit the operation of private schools on a discriminatory basis, but states that the policy of the United States is to discourage discrimination in such schools. The revenue ruling cites to the "well-settled" Federal policy against discrimination in many areas of wide public interest and to "developments of recent decades and recent years reflect[ing] a Federal policy against racial discrimination which extends to racial discrimination in education. Titles IV and VI, The Civil Rights Act of 1964 . . . and *Brown v. Board of Education* . . . and many subsequent Federal court cases, demonstrate a national policy to discourage racial discrimination in education, whether public or private."

Based on the permanent injunction in *Green v. Connally*, the IRS also issued Rev. Proc. 75-50, 1975-2 C.B. 587, modified by Rev. Proc. 2019-22, 2019-22 I.R.B. 1260, to set forth guidelines and recordkeeping requirements for determining whether private schools that apply for recognition of exemption from Federal income tax under section 501(c)(3), or are presently recognized as exempt from tax, have racially nondiscriminatory policies as to students. Section 3.01 of Rev. Proc. 75-50 defines a "racially nondiscriminatory policy as to students" by reference to policies addressed by Rev. Rul. 71-447. The first sentence of section 3.02 of Rev. Proc. 75-50 clarifies that "discrimination on the basis of race" includes discrimination on the basis of color and national or ethnic origin. The second sentence of section 3.02 of Rev. Proc. 75-50 states that a "policy of a school that favors racial minority groups with respect to admissions, facilities and programs, and financial assistance will not constitute discrimination on the basis of race when the purpose and effect is to promote the establishment and maintenance of that school's racially nondiscriminatory policy as to students." Likewise, the third and fourth sentences of section 4.05 of Rev. Proc. 75-50 state: "Consistent with section 3.02, *supra*, scholarships and loans that are made pursuant to financial assistance programs favoring members of one or more racial minority groups that are designed to promote a school's racially nondiscriminatory policy will not adversely affect the school's exempt status. Financial assistance programs favoring members of one or more racial groups that do not significantly derogate from the school's racially nondiscriminatory policy similarly will not adversely affect the school's exempt status."

On May 24, 1983, the Supreme Court decided *Bob Jones University v. United States*, 461 U.S. 574 (1983). In that case, the Court held that the IRS did not exceed its authority when it announced its interpretation of section 501(c)(3) in Rev. Rul. 71-447, and upheld the IRS's revocation of

[1] Section 1 of the Civil Rights Act of 1866 is codified at 42 U.S.C. 1981 and provides that all persons in the United States shall have the same right to "make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens."

[2] The Restatement of Trusts is a treatise published by the American Law Institute that restates and clarifies the common law of trusts in the United States.

the section 501(c)(3) status of Bob Jones University and the Goldsboro Christian Schools, Inc. These schools maintained racially discriminatory policies promoting racial segregation, which the Court held were contrary to a fundamental public policy. *Id*. at 593. The Court reasoned that, in analyzing section 501(c)(3), there was unmistakable evidence that entitlement to a tax exemption depends on meeting a "charitable" standard under common law; that is, serving a public purpose and not being contrary to established public policy. *Id*. at 586. The Court further stated, "[a]n unbroken line of cases following *Brown v. Board of Education* establishes beyond doubt this Court's view that racial discrimination in education violates a most fundamental national public policy, as well as rights of individuals," specifying that "[t]he right of a student not to be segregated on racial grounds in schools . . . is indeed so fundamental and pervasive that it is embraced in the concept of due process of law." *Id*. at 593 (internal cites omitted). The court also cited to numerous acts of Congress, including the Civil Rights Act of 1964, and numerous executive orders "demonstrating the commitment of the Executive Branch to the fundamental policy of eliminating racial discrimination" for its conclusion that "[r]acially discriminatory educational institutions cannot be viewed as conferring a public benefit within the 'charitable' concept ... or within Congressional intent underlying § 170 and § 501(c)(3)." *Id*. at 595-96.

The authorities described in this Background section establish that racial discrimination in education violates a fundamental public policy of the United States and that schools engaging in racial discrimination are ineligible for section 501(c)(3) status.

III. *Developments regarding racial discrimination in education*

In the 1970s, some universities adopted "affirmative action" admissions policies considering race as one factor among others to increase the enrollment of racial minority students in their programs, and courts began to delineate constitutional limits, emphasizing that programs must be narrowly tailored and serve compelling interests. For example, the Supreme Court in *Regents of the University of California v. Bakke,* 438 U.S. 265 (1978), addressed whether the University of California violated the Fourteenth Amendment's Equal Protection Clause, and Title VI of the Civil Rights Act of 1964, by practicing an "affirmative action" policy that resulted in the repeated rejection of a white male's application for admission to its medical school.

The *Bakke* Court was divided. Led by Justice Stevens, four justices concluded that Title VI categorically prohibited using race as the basis for excluding persons from participation in federally funded programs, and that the use of racial quotas in university admissions constituted such an exclusion. 438 U.S. at 421. Four other justices, led by Justice Brennan, argued that Title VI's prohibition on racial discrimination was coextensive with the Equal Protection Clause of the Fourteenth Amendment, that the Equal Protection Clause did not bar the use of race-based criteria that were designed to mitigate the effects of racial discrimination, and accordingly that the use of racial quotas in admissions was not illegal. 438 U.S. at 328, 362, 378. Justice Powell's opinion announcing the judgment of the Court landed between these two camps. Powell concurred with Brennan that Title VI was coextensive with the Equal Protection Clause, but found that any race-based classification, even for a purportedly benign purpose, was subject to strict scrutiny. *Id*. at 299. Justice Powell held that the practice of setting a specific quota for specific racial groups could not survive strict scrutiny, but that an admissions program which was aimed at attaining the benefits of a diverse student body and treated race as just one element among many in an applicant's profile was constitutionally permissible. *Id*. at 318-20. Thus, although the Court struck down the use of racial quotas, the Court allowed race to be considered as one of many factors to be considered in admissions.

Approximately 25 years later, the Supreme Court addressed in *Grutter v. Bollinger*, 539 U.S. 306 (2003), whether the University of Michigan Law School's use of racial preferences in student admissions violated the Equal Protection Clause of the Fourteenth Amendment or Title VI of the Civil Rights Act of 1964. Looking to Justice Powell's opinion in *Bakke*, the Court reiterated that maintaining the diversity of a university's student body was a compelling state interest which could justify race-conscious admissions policies. *Id*. at 325. The Court further found that the University of Michigan's policies were narrowly tailored to that interest because review of every student's application was highly individualized, race was one of many types of diversity considered in the process, and acceptance or rejection was not automatic based on the presence of a single variable such as race. *Id*. at 336-38. However, the Court noted that race-conscious admissions policies should be limited in time since "[a] core purpose of the Fourteenth Amendment was to do away with all governmentally imposed discrimination based on race." *Id*. at 341. The Court further stated that "racial classifications, however compelling their goals, are potentially so dangerous that they may be employed no more broadly than the interest demands," so a permanent justification for racial preferences would be contrary to the principle of equal protection. *Id*. at 342. Justice O'Connor expressed an expectation that 25 years from the date of the opinion, "the use of racial preferences will no longer be necessary to further the interest approved today." 539 U.S. at 343 (internal citations omitted).

That same year, the Supreme Court, in *Gratz v. Bollinger*, 539 U.S. 244 (2003), addressed whether the University of Michigan's use of racial preferences in undergraduate admissions violated the Equal Protection Clause of the Fourteenth Amendment and Title VI of the Civil Rights Act of 1964. The Court found that the undergraduate admissions policy of awarding automatic "points" for race was mechanical, not individualized, and made race a decisive factor in the admissions process. *Id.* at 271-72, 274. As such, the Court held that the undergraduate admissions policies were not sufficiently narrowly tailored to meet the strict scrutiny standard. *Id.* at 270. Because the policy did not provide individualized consideration of applicants but rather resulted in the admission of nearly every qualified applicant of "underrepresented minority" status, it was not narrowly tailored in the manner required by previous jurisprudence to not violate the Equal Protection Clause of the Fourteenth Amendment and Title VI of the Civil Rights Act of 1964. *Id*.

In 2016, in *Fisher v. University of Texas*, 579 U.S. 365 (2016), the Supreme Court again addressed whether the Equal Protection Clause of the Fourteenth Amendment permits the consideration of race in undergraduate admissions decisions. The Court held that the race-conscious admissions program in use at the time by the University of Texas was lawful under the Equal Protection Clause. *Id.* at 388. That admissions program had been carefully crafted in light of *Grutter*, with the goal of providing the educational benefits of a diverse student body. The court found that the University had met its burden of showing that the admissions policy was narrowly tailored, although it noted that it "remains an enduring challenge to our Nation's education system to reconcile the pursuit of diversity with the constitutional promise of equal treatment and dignity." *Id*. at 368. The court observed that the University must continue to use its data about the manner in which different approaches to admissions may foster diversity or instead dilute it to scrutinize the fairness of its admissions program, to assess whether the changing demographics have undermined the need for a race-conscious admissions policy, and to study the positive and negative effects of its affirmative action measures. *Id.*

Most recently, the Supreme Court held in *Students for Fair Admissions, Inc. v. President and Fellows of Harvard College*, 600 U.S. 181 (2023), that the admissions policies of Harvard College and the University of North Carolina had employed unlawful racial discrimination in violation of Title VI of the Civil Rights Act of 1964 and the Equal Protection Clause of the Fourteenth Amendment, respectively. The Court discussed the exacting nature of the strict scrutiny standard necessary to justify racial discrimination under the Equal Protection Clause, explaining that, "[o]ur acceptance of race-based state action has been rare for a reason. Distinctions between citizens solely because of their ancestry are by their very nature odious to a free people whose institutions are founded upon the doctrine of equality. That principle cannot be overridden except in the most extraordinary case." *Id*. at 208 (internal cites omitted). Ultimately, the Court found that these universities' race-based admissions policies did not survive strict scrutiny because they "lack sufficiently focused and measurable objectives warranting the use of race, unavoidably employ race in a negative manner, involve racial stereotyping, and lack meaningful end points." *Id*. at 230. The Court found flaw with the dissenting opinions (which would have upheld the race-based admissions programs based on remedying the effects of societal discrimination), stating that "[i]n the years after *Bakke*, the Court repeatedly held that ameliorating societal discrimination does not constitute a compelling interest that justifies race-based state action." *Id*. at 226.

Explanation of Provisions

These proposed regulations would provide that all forms of racial discrimination in education, regardless of the intent behind or the legality of such discrimination (for example, where such discrimination is defended as serving remedial or diversity-related objectives), are against a fundamental public policy of the United States and thus preclude a school's exemption from Federal income tax under section 501(c)(3). In so doing, the proposed regulations would make clear that discriminating based on race, color, or national or ethnic origin for any purpose by a private school is contrary to a fundamental public policy of the United States. This public policy is evidenced by antidiscrimination law such as the Equal Protection Clause of the Fourteenth Amendment, the Civil Rights Act of 1964, Supreme Court case law such as *Brown* to *Runyon* to *Bob Jones* to *Students for Fair Admissions*, and the actions taken by the Executive Branch to ensure racial nondiscrimination is instituted throughout the United States.[3]

If these regulations are finalized as proposed, certain portions of Rev. Proc. 75-50, concerning private schools favoring racial minority groups with respect to admissions, facilities and programs, and financial assistance, would be incompatible with the new rules. Accordingly, Rev. Proc. 75-50, as modified by Rev. Proc. 2019-22, would be modified by deleting the second sentence of section 3.02 and the third and fourth sentences of section 4.05. Consistent with these proposed rules, these modifications would take effect with respect to taxable years of private schools beginning after May 31, 2027, which is expected to be after the date of publication of final regulations in the ***Federal Register***: Apart from these modifications, Rev. Proc. 75-50 (as modified by Rev. Proc. 2019-22) would remain in effect.

For the avoidance of any doubt, the proposed regulations would not preclude a private school from maintaining a religious mission, curriculum, or program of observance, or from selecting students on the basis of religious affiliation or membership. Use of a religiously based selection criterion does not become discrimination on the basis of race, color, or national or ethnic origin merely because members of the relevant religious community may also share ancestry or ethnic characteristics (so long as the selection criteria is based solely on religion and not on shared ancestry or ethnic characteristics). Similarly, the proposed regulations would not disturb the continued ability of an organization (including a private school) to take actions or adopt policies intended to eliminate prejudice and discrimination, consistent with existing §1.501(c)(3)-1(d)(2), provided the organization achieves these purposes by means other than actions or policies that discriminate on the basis of race, color, or national or ethnic origin.

Incorporating the long-standing holding of Rev. Rul. 71-447 in regulatory text and removing the language in Rev Proc. 75-50 as to the favoring of racial minority groups to further a school's racially nondiscriminatory purpose would allow for more consistent application of Federal tax law across the United States and make

[3] *See, e.g.*, Executive Order 10730 (22 FR 7628; Sep. 24, 1957) (authorizing the use of the National Guard to enforce the desegregation of public schools in Little Rock, Arkansas); Executive Order 14173 (90 FR 8633; Jan. 21, 2025) (directing agency heads to create plans to deter illegal discrimination, including at institutions of higher education); Executive Order 14280 (90 FR 17533; April 23, 2025) (directing the Secretary of Education and Attorney General to take action aimed at preventing racial discrimination in school disciplinary systems).

clear to all private schools (that is, all private primary and secondary schools, colleges, professional or trade schools, and universities) the need to eliminate all impermissible racially discriminatory policies incompatible with the benefit of Federal income tax exemption. The proposed regulations would achieve this result by stating a clear, enforceable standard: private schools cannot qualify as "operated exclusively for exempt purposes" within the meaning of section 501(c)(3) if they adopt, maintain, or enforce any policy or practice that discriminates on the basis of race, color, or national or ethnic origin in the administration of any educational policy, admissions policy, scholarship or loan program, athletic program, or other school-administered or supported program.

The proposed regulations would achieve these objectives by adding a new §1.501(c)(3)-2 to 26 CFR part 1.

Proposed §1.501(c)(3)-2(a) would provide the general rule that a private school (as defined in proposed §1.501(c)(3)-2(c)) must be operated exclusively for exempt purposes (within the meaning of §1.501(c)(3)-1(d)) to be an organization described in section 501(c)(3). It would also provide that a private school that fails to satisfy the nondiscrimination requirement of proposed §1.501(c)(3)-2(b) will not be exempt from Federal income tax under section 501(c)(3) with respect to taxable years beginning after May 31, 2027, which is after the date final regulations are expected to be published in the ***Federal Register***.

Proposed §1.501(c)(3)-2(b) would provide that a private school is not "operated exclusively for exempt purposes" if it adopts, maintains, or enforces any policy or practice that discriminates on the basis of race, color, or national or ethnic origin in the administration of any educational policy, admissions policy, scholarship and loan program, athletic program, or other school-administered or school-supported program. Proposed §1.501(c)(3)-2(b) would add that, for this purpose, policies or practices that discriminate on the basis of race, color, or national or ethnic origin include policies or practices that so discriminate for any purpose.

Lastly, proposed §1.501(c)(3)-2(c) would provide that for purposes of proposed §1.501(c)(3)-2, the term "private school" means an organization that (determined without regard to the nondiscrimination requirement of paragraph (b)) is described in section 501(c)(3) and classified as an educational organization described in section 170(b)(1)(A)(ii) (that is, any private primary or secondary school, college, professional or trade school, or university). The term does not include a governmental unit, an agency or instrumentality of a governmental unit, or an organization owned or operated by an agency or instrumentality of a governmental unit.

The proposed regulations are intended to clarify the law applicable to qualification for the Federal tax exemption of private schools, which would eliminate ambiguity and ensure consistent application across all private schools. The proposed regulations would also provide administrative certainty for IRS personnel and ensure that Federal income tax exemption does not benefit racially discriminatory practices in education.

Proposed Applicability Date

The Treasury Department and the IRS expect to finalize these regulations, with any necessary modifications based on timely comments received, in advance of May 31, 2027. These regulations are proposed to apply to taxable years of private schools beginning after May 31, 2027. This proposed applicability date will allow any private schools that may need to amend their existing policies, including admissions or scholarship policies, to do so before the beginning of any taxable year to which the final regulations are expected to apply.

Special Analyses

I. *Regulatory Planning and Review*

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

These proposed regulations have been designated by the Office of Management and Budget's (OMB's) Office of Information and Regulatory Affairs (OIRA) as subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (July 4, 2025) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. OIRA has determined that the proposed rulemaking is significant and subject to review under Executive Order 12866 and section 1(b) of the Memorandum of Agreement. Accordingly, the proposed regulations have been reviewed by OMB.

A. *Need for Regulation*

The proposed regulations would provide that a private school which discriminates on the basis of race, color, or national or ethnic origin in the administration of its policies is not operated "exclusively for charitable purposes." Therefore, a private school which engages in racial discrimination cannot qualify for exemption from Federal income tax. Consistent with recent developments in the law,[4] these regulations hold that racial discrimination in education is impermissible, regardless of its intent (for example, to ameliorate the effects of past racial discrimination).

B. *The Statute and the Proposed Regulations*

The proposed regulations would provide that a private school cannot meet the definition of an organization exempt from Federal income tax if it discriminates on the basis of race, color, or national or ethnic origin in administration of its educational, admissions, scholarship, athletic, or other policies. It would further define race-based action for the purpose of ameliorating societal discrimination as a form of discrimination. These regulations would apply to private primary, secondary, preparatory, or high schools, as well

[4] *See Students for Fair Admissions v. President and Fellows of Harvard College,* 600 U.S. 181 (2023) (*SFFA*).

as colleges and universities, for taxable years beginning after May 31, 2027.

C. *Baseline*

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

D. *Affected Entities and Taxpayers*

The Treasury Department and the IRS estimate that the proposed regulations may affect the 18,000 private elementary, secondary, and post-secondary schools in the United States that currently qualify for tax exempt status and the 750,000 students attending these schools who may qualify for scholarships allocated on the basis of racial, ethnic, or national identity.[5] In addition, the Treasury Department and the IRS estimate that the proposed regulations may also affect taxpayers who donate to scholarship funds administered by private schools, and that use racial criteria to determine eligibility to receive scholarship funds. The Treasury Department and the IRS do not have readily available parameters and models to quantify the number of taxpayers who make charitable contributions to support race-based scholarship funds administered by private schools.

E. *Economic Effects of the Proposed Regulations*

As postsecondary schools have already changed their admissions policies following the Supreme Court's decision in *Students for Fair Admissions* (*SFFA)*, the Treasury Department and the IRS anticipate that all economic effects of this proposed regulation on postsecondary schools will follow from the requirement to apply such definition of discrimination to the administration of scholarship and loan policies.

The Treasury Department and the IRS expect that all private primary and secondary schools will adjust their admissions criteria to conform to the proposed regulations, so that they may retain their tax-exempt status.[6] The proposed regulations provide that to maintain tax exempt status, schools may not discriminate on the basis of race in their admissions policies, but the Treasury Department and the IRS are not aware of any data that would provide the extent to which private primary and secondary schools currently discriminate on the basis of race and ethnicity when admitting students. Further to the extent that the number of primary and secondary students being educated is unchanged, it is expected that the change in the racial composition of primary and secondary students among public and private primary and secondary schools will have a minimal effect on primary and secondary student outcomes or economic growth in general. The Treasury Department and the IRS also do not have the data to model the cost to schools (that currently discriminate based on race or ethnicity) of changing admission criteria to maintain compliance. Low-cost options to maintain compliance may be available to many schools, but some schools may choose higher cost options in order to meet other objectives. To the extent that primary and secondary schools have preemptively adjusted admission criteria in the wake of the *SFFA* decision regarding postsecondary schools and to the extent that low cost compliance options are available (even if not chosen), compliance costs with regard to private primary and secondary school admission would be minimal.

The proposed regulations are not expected to affect private school athletic programs where inclusion is generally based on athletic ability, not race or ethnicity. Further, while the proposed regulations might also affect any other school-supported programs or education policies administered by private schools, the Treasury Department and the IRS assume that any economic effects arising from this relatively narrow, miscellaneous group of activities would be insignificant.

The proposed regulations are expected to have three types of economic effects on private school financial aid policies. First, private schools may incur some legal and administrative costs as they endeavor to comply with the proposed regulations. Second, the proposed regulations may affect the distribution of scholarship and loan funds among the population of students. Third, the proposed regulations may affect the charitable giving behavior of donors who wish to provide scholarships or loans where race, ethnicity, or national origin are included in the set of eligibility criteria. In all cases, if these nondiscrimination rules are finalized as proposed, the Treasury Department and the IRS expect that private schools will comply in order to maintain their tax-exempt status. This assumption is based on the observed compliance with the Supreme Court ruling in *SFFA*.[7]

---

[5] The Treasury Department and the IRS do not collect information on race or ethnicity. The number of students potentially qualifying for scholarships based on race or ethnicity is estimated using a survey conducted by the GAO, (Linda G. Morra, "Higher Education: Information on Minority-Targeted Scholarships," U.S. Government Accountability Office (GAO), HEHS-94-77, January 14, 1994; last accessed February 19, 2026. *https://www.gao.gov/assets/hehs-94-77.pdf).*

[6] Private primary and secondary schools were not directly affected by *SFFA.* However, following *SFFA,* several prominent advisors to private primary and secondary schools anticipated that this decision would ultimately come to apply to K-12 private schools as well, and advised schools to adapt their admissions processes accordingly. Treasury and the IRS therefore anticipate that a subset of these schools have already changed their admissions policies to reflect a definition of discrimination close to the one in the proposed rule. Smith, Kristin L. 2023. "6 Steps for Private and Independent Schools in the Wake of the SCOTUS Affirmative Action Ruling." *https://www.fisherphillips.com/en/insights/insights/private-and-independent-schools-scotus-affirmative-action-ruling.* Pass, Caryn G., Grace H. Lee, Janice P. Gregerson, and Ashley E. Sykes. 2023. "No More Affirmative Action: What Does the Supreme Court's Decision Mean for Independent Schools?" *https://www.venable.com/insights/publications/2023/07/no-more-affirmative-action-what-does*.

[7] Prior to *SFFA,* experts anticipated that a race-blind admissions policy would impact the racial composition at only the most selective institutions, reducing the share of their student body which comes from historically underrepresented racial, ethnic, or national groups, and correspondingly increasing the share of other students represented on these campuses (Reber, Goodman, and Nagashima (2023)). Recent research finds evidence that *SFFA* has had this expected effect on admissions. In the year following *SFFA,* the shares of Black, Native American, Hispanic/Latino, Native Hawaiian, and Pacific Islander students enrolled at the most selective schools fell (Snider, 2026). These findings are corroborated by Bloem et al. (2026), which further shows that these students instead enrolled at less-selective schools, while the highest-achieving students belonging to other races, ethnicities, and nationalities, and residing in low-income neighborhoods, were more likely to attend "Ivy Plus" colleges following *SFFA.* As the anticipated effect of this policy has thus far been borne out in empirical data, this evidence is consistent with compliance with the Supreme Court ruling in *SFFA.* Bloem, Michael D., Ashley Edwards, J. Parker Goyer, Jessica Howell, Xiaowen Hu, Michael Hurwitz, Samuel J. Imlay, Jennifer Ma, and Matea Pender. 2026. "College Enrollment Patterns After SFFA v. Harvard." EdWorkingPaper: 26-1392. Retrieved from Annenberg Institute at Brown University: https://doi.org/10.26300/6a7w-bq06. Reber, Sarah, Gabriela Goodman, and Rina Nagashima. 2023. "Admissions at most colleges will be unaffected by Supreme Court ruling on affirmative action." *https://www.brookings.edu/articles/admissions-at-most-colleges-will-be-unaffected-by-supreme-court-ruling-on-affirmative-action/*. Snider, Emily. 2026. "The Impact of the 2023 Students for Fair Admissions v Harvard Decision on Undergraduate Demographics." EdWorkingPaper: 26-1471. Retrieved from Annenberg Institute at Brown University: *https://doi.org/10.26300/98fw-8558*.

1. Compliance costs for private schools

Private schools may incur some legal and administrative costs as they endeavor to comply with the proposed regulations. These costs will depend, in part, on the legal circumstances under which a race-based scholarship was created. In the event that a race-based scholarship was endowed by a donor, whose letter of intent explicitly stated that eligibility relies on race-based criteria, schools may need to work with the donors, or the donors' heirs, to find an alternative set of eligibility criteria for the scholarship recipients. This process will incur administrative and legal costs. The Treasury Department and the IRS do not have readily available parameters or models to precisely assess the extent of such costs. However, only a minority of scholarship dollars are restricted by the donor's intention: scholarship dollars funded by any restricted endowment (restricted by race, ethnicity or any other criterion) represent no more than 16 percent of total scholarship dollars.[8]

Most scholarships and loans offered by private schools are not endowed by a donor with the express intent of restricting eligibility based on race, ethnicity, or national origin. For these scholarships and loans, private schools would have the latitude to revise eligibility criteria to conform to the proposed regulation's definition of racial nondiscrimination. In this case, private schools may use a different mechanism for allocating scholarships and loans to recipients, for example, using geographic or income-based criteria in lieu of a racial or ethnic criterion to determine scholarship eligibility. The shift to using a different mechanism is not expected to result in significant compliance costs and may be the preferred method for maintaining compliance while targeting scholarships and loans to certain students.

2. Changes in recipient population

The proposed regulations may affect the distribution of private school scholarship and loan funds among the population of students. This would result in a change in the composition of the pool of scholarship and loan recipients, but the total value of scholarships and loans awarded, and the number of scholarship and loan recipients, are not expected to change. The degree to which the composition of the pool of scholarship and loan recipients changes may also be limited.

The Treasury Department and the IRS expect that donors may continue to donate to private schools using alternative criteria, such as income, geography, or first-generation student status. The use of these alternative criteria results in a weaker relationship with race and ethnicity and a stronger relationship with other indicators of disadvantage such as income.[9] The Treasury Department and the IRS therefore anticipate that, should donors come to rely on alternative criteria, their gifts would ultimately benefit a population of scholarship recipients whose socioeconomic characteristics are similar to, but do not precisely coincide with, those of the counterfactual set of individuals who would have received scholarships in the absence of the proposed rule.

The Treasury Department and the IRS also expect that almost all private schools, in order to maintain their tax-exempt status, will adjust their scholarship and loan criteria to conform to the regulations if finalized as proposed. To the extent the new criteria used by private schools to distribute scholarships and loans among their students (for example, income and geography) are correlated with race and ethnicity, the change in the recipient population may be limited. The Treasury Department and the IRS do not have readily available parameters and models to more precisely assess the correlation between race and ethnicity and other possible criteria that may be used by private schools to distribute scholarships and loans.

3. Charitable giving behavior of donors

The Treasury Department and the IRS expect that the proposed regulation may affect the charitable giving behavior of donors who wish to provide scholarships or loans where race, ethnicity, or national origin are included in the set of eligibility criteria. These donors may find that eligibility criteria other than race, ethnicity, or national origin, can also be well-suited to promoting educational attainment for certain families. While the proposed rule does prevent these donors from granting scholarships based on race, ethnicity, or national origin through schools, these donors retain the ability to fund other scholarships. By funding these alternative scholarships, donors may achieve substantially similar outcomes – both for the beneficiaries of their gifts, and with respect to their own tax liability – under the proposed rule as they would have achieved in its absence. As such, the Treasury Department and the IRS expect that the regulation will have a negligible impact on this subset of charitable donors.

II. *Paperwork Reduction Act*

The proposed regulations do not create new collection requirements, as defined under the Paperwork Reduction Act (44 U.S.C. 35); and do not alter any previously approved OMB information collection requirements and their associated burden.

III. *Regulatory Flexibility Act*

The Secretary of the Treasury certifies 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 although these proposed regulations may affect as many as 18,000 private elementary, secondary, and post-secondary schools, the proposed regulations would not impose new economically significant requirements on a substantial number of small entities seeking Federal income tax exemption other than legal requirements such entities likely

---

[8] U.S. Department of Education, National Center for Education Statistics, Integrated Postsecondary Education Data System (IPEDS), Spring 2025, Finance component, retrieved on February 10, 2026, from *https://nces.ed.gov/ipeds/use-the-data*. This share represents the share of all institutional grants to students which are funded by endowments. Unfunded institutional grants include the amount awarded to students from unrestricted institutional resources. Funded institutional grants include the amounts awarded to students from institutional resources restricted for the purpose of student aid, such as scholarships and fellowships funded by gifts or endowment return restricted for that purpose.

[9] Levine, Phillip, and Sarah Reber. 2023."Can colleges afford class-based affirmative action?" Technical report, The Brookings Institution. *https://www.brookings.edu/articles/can-colleges-afford-class-based-affirmative-action/.* Epple, Dennis, Richard Romano, and Holger Sieg. "Diversity and affirmative action in higher education." Journal of Public Economic Theory 10.4 (2008): 475-501.

already comply with. The proposed regulations also would not impose a collection of information on any entities (including small entities). The economic effects of the proposed regulations would follow from the administration of scholarship and loan policies by these private schools, with effects on athletics and any other school-supported programs or education policies administered by private schools being insignificant.

Private schools may incur some legal and administrative costs as they endeavor to comply with the regulations if finalized as proposed to the extent of any race-based scholarships that are endowed by a donor, whose letter of intent explicitly stated that eligibility relies on race-based criteria. The income from a scholarship endowment is restricted to fund scholarships, so the impact of eliminating or transferring any such funds on the operating budget and investment assets of the school would be minimal. To the extent that such private schools have preemptively adjusted admissions and scholarship criteria in the wake of the *SFFA* decision, any such effects would be attenuated towards zero.

The Treasury Department and the IRS do not have readily available parameters and models to precisely assess the extent to which affected private schools would pursue shifting criteria, returning funds, or maintaining funds without granting race-based scholarships, or the cost of implementing such changes. However, only a minority of scholarship dollars are restricted by the donor's intention: scholarship dollars funded by any restricted endowment (restricted by race, ethnicity, or any other criterion) represent no more than 16 percent of total scholarship dollars.[10] As such, the Treasury Department and the IRS believe any legal and administrative costs to comply with the regulations (if finalized as proposed) for those private schools with existing endowed race-based funds would not have a significant economic impact on a substantial number of small entities.

Notwithstanding this certification 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 comments on the economic impacts these proposed regulations may have on small entities.

IV. *Section 7805(f)*

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

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. These proposed 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.

VI. *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, do not impose substantial direct compliance costs on State and local governments, and do not preempt State law within the meaning of the Executive order.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the Treasury Department and the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. Any comments submitted will be made available at *https://www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that 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, time, and place for the hearing will be published in the ***Federal Register***.

Effect on Other Documents

If these rules are finalized as proposed, Rev. Proc. 75-50, as modified by Rev. Proc. 2019-22, would be modified by deleting the following sentences which are incompatible with the proposed rules:

1. The second sentence of section 3.02.
2. The third and fourth sentences of section 4.05.

Statement of Availability of IRS Documents

Rev. Rul. 71-447 and Rev. Proc. 75-50 were published in the *Internal Revenue Bulletin* and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *https://www.irs.gov*.

Drafting Information

The principal author of these proposed regulations is the 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 in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

[10] *See Id.*

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 26 CFR part 1 continues to read, in part, as follows:

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

* * * * *

Par. 2. Section 1.501(c)(3)-2 is added to read as follows:

§1.501(c)(3)-2 Racial nondiscrimination requirement for private schools.

(a) *In general.* A private school (as defined in paragraph (c) of this section) must be operated exclusively for one or more exempt purposes (as defined in §1.501(c)(3)-1(d)) to be an organization described in section 501(c)(3) of the Internal Revenue Code (Code). A private school that fails to satisfy the nondiscrimination requirement of paragraph (b) of this section is not an organization described in section 501(c)(3) with respect to any taxable year of the private school described in paragraph (d) of this section.

(b) *Nondiscrimination requirement*. A private school is not operated exclusively for exempt purposes if it adopts, maintains, or enforces any policy or practice that discriminates on the basis of race, color, or national or ethnic origin in the administration of any educational policy, admissions policy, scholarship or loan program, athletic program, or other school-administered or school-supported program. For purposes of this section, discrimination on the basis of race, color, or national or ethnic origin includes any discrimination on the basis of race, color, or national or ethnic origin for any purpose.

(c) *Private school defined*. For purposes of this section, the term *private school* means an organization described in section 501(c)(3) (determined without regard to the nondiscrimination requirement of paragraph (b) of this section) and classified as an educational organization described in section 170(b)(1)(A)(ii) of the Code. The term private school does not include a governmental unit, an agency or instrumentality of a governmental unit, or an organization that is owned or operated by an agency or instrumentality of a governmental unit. For purposes of this definition, the term *governmental unit* means the United States, a State, an Indian Tribal government (within the meaning of section 7701(a)(40) of the Code), the District of Columbia, a possession of the United States, or a political subdivision of any of the foregoing.

(d) *Applicability date*. This section applies with respect to the taxable year of any private school beginning after May 31, 2027.

Frank J. Bisignano,
Chief Executive Officer.

(Filed by the Office of the Federal Register September 3, 2026, 8:45 a.m., and published in the issue of the Federal Register for September 4, 2026, 91 FR 56811)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

Bulletin 2026–39

Announcements:

2026-11, 2026-29 I.R.B. *49*
2026-12, 2026-29 I.R.B. *50*
2026-13, 2026-32 I.R.B. *173*
2026-14, 2026-34 I.R.B. *180*
2026-15, 2026-35 I.R.B. *214*
2026-16, 2026-39 I.R.B. 413

Notices:

2026-39, 2026-27 I.R.B. *1*
2026-38, 2026-28 I.R.B. *30*
2026-40, 2026-28 I.R.B. *33*
2026-41, 2026-29 I.R.B. *39*
2026-42, 2026-29 I.R.B. *41*
2026-43, 2026-29 I.R.B. *42*
2026-21, 2026-30 I.R.B. *51*
2026-44, 2026-32 I.R.B. *143*
2026-28, 2026-34 I.R.B. *177*
2026-46, 2026-35 I.R.B. *182*
2026-48, 2026-35 I.R.B. *185*
2026-49, 2026-35 I.R.B. *198*
2026-50, 2026-36 I.R.B. *242*
2026-51, 2026-38 I.R.B. *314*

Proposed Regulations:

REG-101355-26, 2026-37 I.R.B. *249*
REG-103844-26, 2026-37 I.R.B. *275*
REG-115145-25, 2026-37 I.R.B. *298*
CC-00349938-26, 2026-38 I.R.B. *317*
REG-107855-25, 2026-38 I.R.B. *333*
REG-117130-25, 2026-38 I.R.B. *343*
REG-119882-25, 2026-38 I.R.B. *355*
REG-115646-25, 2026-39 I.R.B. *414*
REG-119986-25, 2026-39 I.R.B. *440*

Revenue Procedures:

2026-25, 2026-29 I.R.B. *45*
2026-18, 2026-30 I.R.B. *53*
2026-26, 2026-31 I.R.B. *131*
2026-32, 2026-32 I.R.B. *146*
2026-28, 2026-33 I.R.B. *175*
2026-30, 2026-35 I.R.B. *212*
2026-32, 2026-39 I.R.B. *406*

Revenue Rulings:

2026-12, 2026-28 I.R.B. *27*
2026-13, 2026-32 I.R.B. *132*
2026-14, 2026-35 I.R.B. *181*
2026-15, 2026-36 I.R.B. *216*
2026-16, 2026-36 I.R.B. *237*
2026-17, 2026-37 I.R.B. *247*

Treasury Decisions:

10051, 2026-31 I.R.B. *118*
10052, 2026-31 I.R.B. *121*
10050, 2026-32 I.R.B. *134*
10053, 2026-36 I.R.B. *237*
10054, 2026-39 I.R.B. *372*

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2026–27 through 2026–52 is in Internal Revenue Bulletin 2025–52, dated December 21, 2025.

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2026–39

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2026–27 through 2026–52 is in Internal Revenue Bulletin 2025–52, dated December 21, 2025.

Internal Revenue Service
Washington, DC 20224

Official Business
Penalty for Private Use, $300

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.