

SUPPORTING STATEMENT
(REG-107047-00 [TD 8985-final])

13088. CIRCUMSTANCES NECESSITATING COLLECTION OF INFORMATION

These regulations relate to the character and timing of gain or loss from certain hedging transactions that are entered into by members of a consolidated group. The regulations apply when one member of the group hedges the risk of another member. The regulations also apply when a member of the consolidated group uses an intercompany transaction to transfer risk to another member of the group. The regulations are needed because related-party hedging is a common business practice and existing regulations deal only with hedges entered into by a taxpayer to reduce its own risk.

These regulations clarify the character of gain or loss from the sale or exchange of property that is part of a business hedge. The regulations address questions that had arisen as a result of the decision of the United States Supreme Court in Arkansas Best. The regulations provide guidance to taxpayers entering into hedging transactions and serve as a basis for resolving pending cases involving gains and losses from hedging.

2. USE OF DATA

Section 1.1221-2(d)(2) permits a consolidated group to elect separate-entity treatment for its hedges. Paragraph (d)(2)(iv) provides that the separate entity election must be made in a separate statement that is to be filed with the group's consolidated return for the taxable year that includes the first date for which the election is to apply. The statement must specify that the election is being made and must indicate the date that the election is to be effective.

Section 1.1221-2(e)(5) contains the single-entity approach. The member entering into the hedging transaction with an unrelated party must identify the hedging transaction and the hedged item in its books and records. If the consolidated group makes the separate-entity election, each member must identify its hedging transactions with unrelated third parties, its intercompany transactions that are treated as hedging transactions under these regulations, and the item being hedged.

The identification requirement is designed to aid the IRS in administering the law and to prevent manipulation, such as recharacterization of transactions in view of later developments. This information will be used to determine whether the taxpayer has elected separate-entity treatment under Section 1.1221-2(d)(2) and to verify that the taxpayer is properly reporting its business hedging transactions.

The regulations require taxpayers to identify hedging transactions entered into on or after January 1, 1994. The identification requirement is designed to aid the IRS in

administering the law and to prevent manipulation, such as recharacterization of transactions in view of later developments. This information is used to verify that a taxpayer is properly reporting its business hedging transactions. If such recordkeeping were not required, then the IRS would not be able to achieve these objectives.

3. **USE OF IMPROVED INFORMATION TECHNOLOGY TO REDUCE BURDEN**

IRS Publications, Regulations, Notices and Letters are to be electronically enabled on an as practicable basis in accordance with the IRS Reform and Restructuring Act of 1998.

4. **EFFORTS TO IDENTIFY DUPLICATION**

We have attempted to eliminate duplication within the agency wherever possible.

5. **METHODS TO MINIMIZE BURDEN ON SMALL BUSINESSES OR OTHER SMALL ENTITIES**

Not applicable.

6. **CONSEQUENCES OF LESS FREQUENT COLLECTION ON FEDERAL PROGRAMS OR POLICY ACTIVITIES**

Not applicable.

7. **SPECIAL CIRCUMSTANCES REQUIRING DATA COLLECTION TO BE INCONSISTENT WITH GUIDELINES IN 5 CFR 1320.5(d)(2)**

Not applicable.

8. **CONSULTATION WITH INDIVIDUALS OUTSIDE OF THE AGENCY ON AVAILABILITY OF DATA, FREQUENCY OF COLLECTION, CLARITY OF INSTRUCTIONS AND FORMS, AND DATA ELEMENTS**

FI-34-94 was published in the **Federal Register** as a notice of proposed rulemaking on July 18, 1994 (59 FR 36394). A public hearing was held on October 18, 1994. The final regulations were published in the **Federal Register** on January 8, 1996 (61 FR 517).

FI-46-93 (58 FR 54075) was published in the **Federal Register** on October 20, 1993, simultaneously with temporary regulations (58 FR 54037). A public hearing was held on January 19, 1994. The final regulations (59 FR 36360) were published in the **Federal Register** on July 18, 1994.

A notice of proposed rulemaking (REG-107047-00), which reinstated the collections of information in FI-34-94 and FI-46-93, was published in the **Federal Register** on

January 18, 2001 (66 FR 4738). A public hearing was held on May 16, 2001. The final regulations (TD 8985) were published in the **Federal Register** on March 20, 2002 (67 FR 12863).

In response to the **Federal Register Notice** dated **February 9, 2012 (77 FR 6859)**, we received no comments during the comment period regarding TD 8985.

9. EXPLANATION OF DECISION TO PROVIDE ANY PAYMENT OR GIFT TO RESPONDENTS

Not applicable.

10. ASSURANCE OF CONFIDENTIALITY OF RESPONSES

Generally, tax returns and tax return information are confidential as required by 26 USC 6103.

11. JUSTIFICATION OF SENSITIVE QUESTIONS

Not applicable.

12. ESTIMATED BURDEN OF INFORMATION COLLECTION

Section 1.1221-2(d)(2) permits a consolidated group to elect separate-entity treatment for its hedges. Paragraph (d)(2)(iv) provides that the separate entity election must be made in a separate statement that is to be filed with the group's consolidated return for the taxable year that includes the first date for which the election is to apply. The statement must specify that the election is being made and must indicate the date that the election is to be effective. We estimate that 2,000 businesses or other for-profit institutions will make the separate-entity election described in paragraph (d)(2) of the regulation, with an estimated burden per respondent of .5 hours, with an estimated total reporting burden of 1,000 hours.

Section 1.1221-2(e)(5) imposes an identification requirement for hedging transactions involving the single-entity approach. The member entering into the hedging transaction with an unrelated party must identify the hedging transaction and the hedged item in its books and records. If the consolidated group makes the separate-entity election, each member must identify its hedging transactions with unrelated third parties, its intercompany transactions that are treated as hedging transactions under these regulations, and the item being hedged. We estimate that 15,000 businesses or other for-profit institutions will make the identification requirement under section 1221-2(e)(5) of the regulation, with an estimated annual burden per recordkeeper of 5 hours, with an estimated total annual recordkeeping burden of 75,000 hours.

Section 1.1221-2(g)(5)(ii) involves past years. To apply the single-entity election to past years, the group must file a statement attached to a federal income tax return (or

amended return). We estimate that 100 groups will make this election and that the burden per respondent is .5 hours. The reporting burden for this requirement is 50 hours.

Paragraph (e) of 1.1221-2 of the regulations imposes an identification requirement with respect to hedging transactions entered into on or after January 1, 1994. A taxpayer must identify the hedging transaction before the close of the day which the taxpayer enters into it. In addition, the taxpayer must identify the item, items, or aggregate risk being hedged substantially contemporaneously with entering into the hedging transaction. These identifications are to be made on the taxpayer's books and records. We estimate that 100,000 businesses or other for-profit institutions will make the identification requirement under section 1.1221-2(e) of the regulations with an estimated annual burden per recordkeeper of .50 hour, with an estimated total annual recordkeeping burden of 50,000 hours.

Paragraph (c)(5)(ii) of §1.1221-2 of the final regulation provides ordinary treatment for hedges of the purchase of noninventory supplies if the taxpayer sells only a negligible amount of the supply. Thus, we estimate that there will be an additional 10,000 businesses or other for-profit institutions that will make the identification requirement under 1.1221-2(e) of the final regulation, with an estimated annual burden per recordkeeper of .50 hour, with an estimated total annual recordkeeping burden of 5,000 hours.

Paragraph (e)(3)(iv) of §1.1221-2 of the regulation expands the required identification for transactions that hedge aggregate risk by requiring the taxpayer to include in its books and records a description of the hedging program under which the hedging transaction was entered. Taxpayers must describe the type of risk being hedged, the hedged items, and sufficient additional information to demonstrate that the program is designed to reduce aggregate risk. We estimate that there will be 40,000 businesses or other for-profit institutions that will make the identification required under 1.1221-2(e)(3)(iv), with an estimated annual burden per recordkeeper of 1 hour, with an estimated total annual recordkeeping burden of 40,000 hours.

Estimates of the annualized cost to respondents for the hour burdens shown are not available at this time.

13. ESTIMATED TOTAL ANNUAL COST BURDEN TO RESPONDENTS

As suggested by OMB, our **Federal Register Notice** dated **February 9, 2012**, requested public comments on estimates of cost burden that are not captured in the estimates of burden hours, i.e., estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information. However, we did not receive any response from taxpayers on this subject. As a result, estimates of the cost burdens are not available at this time.

14. ESTIMATED ANNUALIZED COST TO THE FEDERAL GOVERNMENT

Not applicable.

15. REASONS FOR CHANGE IN BURDEN

There is no change in the paperwork burden previously approved by OMB. We are making this submission to renew the OMB approval.

16. PLANS FOR TABULATION, STATISTICAL ANALYSIS AND PUBLICATION

Not applicable.

17. REASONS WHY DISPLAYING THE OMB EXPIRATION DATE IS INAPPROPRIATE

We believe that displaying the OMB expiration date is inappropriate because it could cause confusion by leading taxpayers to believe that the regulation sunsets as of the expiration date. Taxpayers are not likely to be aware that the Service intends to request renewal of the OMB approval and obtain a new expiration date before the old one expires.

18. EXCEPTIONS TO THE CERTIFICATION STATEMENT ON OMB FORM 83-I

Not applicable.

Note: The following paragraph applies to all of the collections of information in this submission:

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.