Internal Revenue bulletin

Bulletin No. 2011-50
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

REG–109564–10, page 852.

Proposed regulations under section 704 of the Code remove section 1.704–1(b)(iii)(e) (the *de minimis* partner rule) because the rule may have resulted in unintended tax consequences.

Notice 2011–99, page 847.

The notice provides a proposed revenue procedure in which the Service will allow a taxpayer to use a simplified proportional method of accounting for original issue discount ("OID") on pools of credit card receivables under section 1272(a)(6) of the Code. The proportional method allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of pool principal that is paid by cardholders during the period.

EXEMPT ORGANIZATIONS

Announcement 2011–76, page 854.

The IRS has revoked its determination that The Big Charity Sale, Inc., of Houston, TX; Echelon Community Services, Inc., of Washington, DC; The GT Foundation of Irvine, CA; Mandala Transformation Foundation of Rafael, CA; San Francisco Medical Research Foundation of Mill Valley, CA; Southern Utah Foundation of Cedar City, UT; and Sunset Non-Profit Housing Association of Murrieta, CA, qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

ESTATE TAX

T.D. 9555, page 838.

Final regulations under section 2036 of the Code provide guidance on the portion of trust property includible in the grantor's gross estate if the grantor has retained the use of the property, the right to an annuity, unitrust, graduated retained interest, or other payment from such property for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death.

EMPLOYMENT TAX

T.D. 9554, page 843.
REG–136565–09, page 851.

Final, temporary, and proposed regulations under section 3121 of the Code would extend the exceptions from taxes under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act under sections 3121(b)(3), 3127, and 3306(c)(5) to entities that are disregarded as separate from their owners for federal tax purposes. The temporary regulations also clarify the existing rule that the owners of disregarded entities, except for qualified subchapter S subsidiaries, are responsible for backup withholding and related information reporting requirements under section 3406.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

Rev. Proc. 2011–58, page 849.
Theft losses from fraudulent investment arrangement. This procedure extends the safe harbor of Rev. Proc. 2009–20 to certain cases in which a lead figure in a specified fraudulent arrangement dies and a state or federal government entity brings a civil complaint against the lead figure or an associated entity. Rev. Proc. 2009–20 modified.

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 and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036–1: Transfers with retained life estate.

T.D. 9555

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 20

Graduated Retained Interests

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance on the portion of property (held in trust or otherwise) includible in the grantor's gross estate if the grantor has retained the use of the property, the right to an annuity, unitrust, graduated retained interest, or other payment from the property for life, for any period not ascertainable without reference to the grantor's death, or for a period that does not in fact end before the grantor's death. The final regulations will affect estates that file Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return.*

DATES: *Effective Date:* These regulations are effective on November 8, 2011.

Applicability Date: For dates of applicability, see §20.2036–1(c)(3).

FOR FURTHER INFORMATION CONTACT: Theresa M. Melchiorre at (202) 622–3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On April 30, 2009, proposed regulations (REG–119532–08, 2009–20 I.R.B. 1017) were published in the **Federal Register** (74 FR 19913). The proposed regulations provide the method required to determine the portion of trust *corpus* of a grantor retained annuity or unitrust trust (GRT) that is includible in the grantor's gross estate under section 2036 if the deceased grantor retains an interest described in §25.2702–3(b)(1)(ii)(A) or (b)(1)(ii)(B) or §25.2702–3(c)(1)(ii); that is, the interest retained by the grantor increases annually during the term of the trust (a graduated retained interest). This method would apply to graduated retained interests in transferred property whether or not held in trust.

In addition, the proposed regulations would add §20.2036–1(c)(1)(ii), *Example 1,* illustrating the amount includible under section 2036 if the decedent transfers property in trust pursuant to the terms of which trust income is payable to the decedent and decedent's child, C, in equal shares during their joint lives and, on the death of the first to die of decedent and C, all trust income is to be paid to the survivor. The proposed regulations also would amend §20.2036–1(b)(1)(ii) to address the method required to determine the amount includible under section 2036 if the decedent and C were entitled to receive annuity interests rather than trust income.

Written comments were received on the proposed regulations. No public hearing was scheduled because no individual or organization requested the opportunity to provide oral comments at a hearing. All comments are available at *www.regulations.gov* or upon request. The proposed regulations, with certain changes made in response to the written comments received, are adopted as final regulations.

Summary of Comments and Explanation of Provisions

Section 20.2036–1(b)(1)(ii) — Determining the portion includible if the decedent's retained annuity follows a preceding annuity interest.

Section 20.2036–1(b)(1)(ii) of the proposed regulations provides the method required to compute the amount includible in the decedent's gross estate under section 2036 in a situation where the decedent is to receive a payment (or an increased payment) after the death of another beneficiary who is receiving an annuity or other payment at the time of the decedent's death. If the decedent predeceases the other beneficiary, under the proposed regulations, the amount includible is the greater of: (1) the amount of *corpus* required to generate sufficient income to pay the annuity payable to the decedent as of the date of death; or (2) the amount of *corpus* required to produce sufficient income to satisfy the annuity or other payment the decedent would have been entitled to receive if the decedent had survived the other beneficiary, reduced by the present value of the other beneficiary's interest. The amount includible, however, cannot exceed the fair market value of the trust *corpus* on the date of death.

One commentator opined that this method attributes to the decedent a greater portion of a trust's value than is appropriate, because the method does not take into account any depletion of trust principal that is assumed if the annuity payable to the current recipient is a greater percentage of the trust corpus than the assumed rate of return based on the applicable section 7520 rate. Alternatively, the commentator proposed that the amount includible under section 2036 should be the sum of: (1) the amount of trust *corpus* required to produce sufficient income to satisfy the annuity or other payment the decedent was receiving at death; plus the lesser of: (A) the amount of trust *corpus* required to produce sufficient income to satisfy the additional annuity payable to the decedent if the decedent had survived the current recipient; or (B) the fair market value of the *corpus* on the date of the decedent's death less the present value of the current recipient's annuity.

The requested approach in the comment was not adopted because it is inconsistent with the existing regulations. The regulations have provided, historically, that if the decedent retained or reserved an interest or right with respect to all or a portion of the property transferred, then the amount includible under section 2036 is the value of the property with respect to which the decedent retained the interest less the value of any outstanding income interest that is not subject to the decedent's retained interest and that is being enjoyed by another person at the time of decedent's

death. Nevertheless, once this computation has been completed, a ceiling on the amount includible in the gross estate under section 2036 (specifically, the fair market value of the trust at death) is imposed. The method in the proposed regulations implements this principle. This method has been clarified in the final regulations by providing that, solely for the purpose of calculating the present value of the current recipient's interest in this computation, the exhaustion of trust *corpus* test described in §20.7520–3(b)(2) is not to be applied in cases where §20.7520–3(b)(2) would otherwise require it to be applied.

Clarification of §20.2036–1(c)(1)(ii), paragraph (i) of Example 1.

In response to a comment, paragraph (i) of *Example 1* in §20.2036–1(c)(1)(ii) has been revised to clarify that the present value of C's outstanding life estate reduces only the 50 percent of trust corpus from which it is payable.

Section 20.2036–1(c)(2)(ii) — Amount includible in the case of a graduated retained interest.

In response to a commentator's request for a detailed example, a step-by-step illustration of the method described in §20.2036–1(c)(2)(ii) (renumbered as §20.2036–1(c)(2)(iii) in the final regulations) has been added in *Example 7* of §20.2036–1(c)(2)(iv).

Section 20.2036–1(c)(2) — Inclusion under sections 2036 and 2033.

One commentator requested that the regulations clarify the interaction of sections 2033 and 2036 in a situation where the decedent establishes a GRT under the terms of which the retained interest is paid to the decedent for a specified term of years and, if the decedent dies prior to the expiration of that term, the retained annuity or other payment is to be paid to the decedent's estate for the balance of the term. See for example §25.2702–3(e), *Example 5*.

The commentator noted that, because all or a portion of the trust *corpus* is includible in the decedent's gross estate under section 2036, the annuity or other payments that become payable after the decedent's death and are required to be paid to the estate for the remainder of the trust term are reflected in the amount includible under section 2036, and therefore should not also be includible under section 2033.

The IRS and the Treasury Department agree. To the extent that all or a portion of the trust *corpus* is includible in the gross estate under section 2036 as a result of the decedent's retained annuity or other interest, double inclusion of the same asset would result if any payment that becomes payable after the decedent's date of death to the estate also is included in the decedent's gross estate under section 2033 as a separate item. Accordingly, §20.2036–1(c)(1)(i) of the regulations has been revised to provide specifically that payments that become payable to the decedent's estate after the decedent's death (as opposed to payments that are payable to the decedent prior to the decedent's death but are not paid until after the decedent's death) are not subject to inclusion under section 2033, if section 2036 is applied to include all or a portion of the trust *corpus* in the gross estate. This rule is also reflected in §20.2036–1(c)(2)(iv), *Example 2* paragraph (ii) and *Example 7*.

The payments described in the preceding paragraph are to be distinguished, however, from annuity or other payments payable to the decedent prior to the decedent's date of death, but that are not paid until after death. Such payments are includible in the decedent's gross estate under section 2033 as a separate receivable. Thus, such an amount payable by the trust reduces the fair market value of the trust as of the date of death, but is included in the decedent's gross estate under section 2033 as a receivable amount.

Organizational changes to and clarification of §20.2036–1(b) and (c).

In response to comments, the method set forth in §20.2036–1(b)(1)(ii) of the proposed regulations for calculating the amount includible if part or all of the decedent's retained annuity follows an annuity interest payable to another at the time of the decedent's death has been moved to a separate section, §20.2036–1(c)(2)(ii). As a conforming change, paragraph (ii) of *Example 1* of §20.2036–1(c)(1)(ii) has been moved and renumbered as *Example 8* of §20.2036–1(c)(2)(iv) in the final regulations.

Also in response to a comment, the manner of computing the amount to be included in the decedent's gross estate has been clarified at the end of §20.2036–1(c)(2)(i).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Theresa M. Melchiorre, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 20 is amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2036–1 is amended by:

1. Revising paragraph (b)(1)(ii).
2. Adding two sentences at the end of paragraph (c)(1)(i).
3. Adding paragraph (c)(1)(ii) *Example 1*.
4. Removing the third sentence of paragraph (c)(2)(i) and adding three new sentences in its place.

5. Redesignating paragraphs (c)(2)(ii) and (c)(2)(iii) as paragraphs (c)(2)(iii) and (c)(2)(iv), respectively.

6. Adding new paragraph (c)(2)(ii) and text to newly-designated paragraph (c)(2)(iii).

7. Revising the introductory text of and adding *Example 7* and *Example 8* to newly-designated paragraph (c)(2)(iv).

8. Adding two sentences at the end of paragraph (c)(3).

The revisions and additions read as follows:

§20.2036–1 Transfers with retained life estate.

* * * * *

(b) * * *

(1) * * *

(ii) A decedent reserved the right to receive the income, annuity, or other payment from transferred property after the death of another person who was in fact enjoying the income, annuity, or other payment at the time of the decedent's death. In such a case, the amount to be included in the decedent's gross estate under this section does not include the value of the outstanding interest of the other person as determined in paragraphs (c)(1)(i) and (c)(2)(ii) of this section. See also, paragraphs (c)(1)(ii) *Example 1* and (c)(2)(iv) *Example 8* of this section. If the other person predeceased the decedent, the reservation by the decedent may be considered to be either for life, or for a period that does not in fact end before death.

* * * * *

(c) * * *

(1) * * *

(i) * * * If this section applies to an interest retained by the decedent in a trust or otherwise and the terms of the trust or other governing instrument provide that, after the decedent's death, payments the decedent was receiving during life are to continue to be made to the decedent's estate for a specified period (as opposed to payments that were payable to the decedent prior to the decedent's death but were not actually paid until after the decedent's death), such payments that become payable after the decedent's death are not includible in the decedent's gross estate under section 2033 because they are properly reflected in the value of the trust corpus included under this section. Payments that become payable to the decedent prior to the decedent's date of death, but are not paid until after the decedent's date of death, are includible in the decedent's gross estate under section 2033.

(ii) * * *

Example 1. Decedent (D) creates an irrevocable *inter vivos* trust. The terms of the trust provide that all of the trust income is to be paid to D and D's child, C, in equal shares during their joint lives and, on the death of the first to die of D and C, all of the trust income is to be paid to the survivor. On the death of the survivor of D and C, the remainder is to be paid to another individual, F. Subsequently, D dies survived by C. Fifty percent of the value of the trust *corpus* is includible in D's gross estate under section 2036(a)(1) because, under the terms of the trust, D retained the right to receive one-half of the trust income for D's life. In addition, the excess (if any) of the value of the remaining 50 percent of the trust *corpus*, over the present value of C's outstanding life estate in that 50 percent of trust *corpus*, also is includible in D's gross estate under section 2036(a)(1), because D retained the right to receive all of the trust income for such time as D survived C. If C had predeceased D, then 100 percent of the trust corpus would have been includible in D's gross estate.

* * * * *

(2) * * *

(i) * * * The portion of the trust's *corpus* includible in the decedent's gross estate for Federal estate tax purposes is that portion of the trust *corpus* necessary to provide the decedent's retained use or retained annuity, unitrust, or other payment (without reducing or invading principal). In the case of a retained annuity or unitrust, the portion of the trust's *corpus* includible in the decedent's gross estate is that portion of the trust *corpus* necessary to generate sufficient income to satisfy the retained annuity or unitrust (without reducing or invading principal), using the interest rates provided in section 7520 and the adjustment factors prescribed in §20.2031–7 (or §20.2031–7A), if applicable. The computation is illustrated in paragraph (c)(2)(iv), *Examples 1*, *2*, and *3* of this section. * * *

(ii) *Decedent's retained annuity following a current annuity interest of another person*. If the decedent retained the right to receive an annuity or other payment (rather than income) after the death of the current recipient of that interest, then the amount includible in the decedent's gross estate under this section is the amount of trust *corpus* required to produce sufficient income to satisfy the entire annuity or other payment the decedent would have been entitled to receive if the decedent had survived the current recipient (thus, also including the portion of that entire amount payable to the decedent before the current recipient's death), reduced by the present value of the current recipient's interest. However, the amount includible shall not be less than the amount of *corpus* required to produce sufficient income to satisfy the annuity or other payment the decedent was entitled, at the time of the decedent's death, to receive for each year. In addition, in no event shall the amount includible exceed the value of the trust *corpus* on the date of death. Finally, in calculating the present value of the current recipient's interest, the exhaustion of trust *corpus* test described in §20.7520–3(b)(2) (exhaustion test) is not to be applied, even in cases where §20.7520–3(b)(2) would otherwise require it to be applied. The following steps implement this computation.

(A) *Step 1*: Determine the fair market value of the trust *corpus* on the decedent's date of death.

(B) *Step 2*: Determine, in accordance with paragraph (c)(2)(i) of this section, the amount of *corpus* required to generate sufficient income to pay the annuity, unitrust, or other payment (determined on the date of the decedent's death) payable to the decedent for the trust year in which the decedent's death occurred.

(C) *Step 3*: Determine, in accordance with paragraph (c)(2)(i) of this section, the amount of corpus required to generate sufficient income to pay the annuity, unitrust, or other payment that the decedent would have been entitled to receive for each trust year if the decedent had survived the current recipient.

(D) *Step 4*: Determine the present value of the current recipient's annuity, unitrust, or other payment (without applying the exhaustion test).

(E) *Step 5*: Reduce the amount determined in Step 3 by the amount determined in Step 4, but not to below the amount determined in Step 2.

(F) *Step 6*: The amount includible in the decedent's gross estate under this section is the lesser of the amounts determined in Step 5 and Step 1.

(iii) *Graduated retained interests*—(A) *In general*. For purposes of this section, a *graduated retained interest* is the grantor's reservation of a right to receive an annuity, unitrust, or other payment as described in paragraph (c)(2)(i) of this section, payable at least annually, that increases (but does

not decrease) over a period of time, not more often than annually.

(B) *Other definitions*—(*1*) *Base amount*. The *base amount* is the amount of *corpus* required to generate the annuity, unitrust, or other payment payable for the trust year in which the decedent's death occurs. See paragraph (c)(2)(i) of this section for the calculation of the base amount.

(*2*) *Periodic addition*. The *periodic addition* in a graduated retained interest for each year after the year in which decedent's death occurs is the amount (if any) by which the annuity, unitrust, or other payment that would have been payable for that year if the decedent had survived exceeds the total amount of payments that would have been payable for the year immediately preceding that year. For example, assume the trust instrument provides that the grantor is to receive an annual annuity payable to the grantor or the grantor's estate for a 5-year term. The initial annual payment is $100,000, and each succeeding annual payment is to be 120 percent of the amount payable for the preceding year. Assuming the grantor dies in the second year of the trust (whether before or after the due date of the second annual payment), the periodic additions for years 3, 4, and 5 of the trust are as follows:

	(1) Annual Payment	(2) Prior Year Payment	(1 - 2) Periodic Addition
Year 3	144,000	120,000	24,000
Year 4	172,800	144,000	28,800
Year 5	207,360	172,800	34,560

(*3*) *Corpus amount*. For each trust year in which a periodic addition occurs (increase year), the *corpus amount* is the amount of trust *corpus* which, starting from the decedent's date of death, is necessary to generate an amount of income sufficient to pay the periodic addition, beginning in the increase year and continuing in perpetuity, without reducing or invading principal. For each year with a periodic addition, the *corpus* amount required as of the decedent's date of death is the product of two factors: the first is the result of dividing the periodic addition (adjusted for payments made more frequently than annually, if applicable, and for payments due at the beginning, rather than the end, of a payment period (see Table K or J of §20.2031–7(d)(6)) by the section 7520 rate (periodic addition / rate)); and the second is 1 divided by the sum of 1 and the section 7520 rate raised to the T power (1 / (1 + rate)^T). The second factor applies a present value discount to reflect the period beginning with the date of death and ending on the last day of the trust year immediately before the year for which the periodic addition is first payable.

(*i*) The *corpus* amount is determined as follows:

$$\frac{\text{(Periodic Addition) x (Adjustment Factor)}}{\text{Section 7520 Rate}} \times \frac{1}{(1+\text{ Section 7520 Rate})^{T}}$$

(*ii*) The adjustment factor, if applicable, is the factor for payments made more frequently than annually and for payments due at the beginning, rather than the end, of a calendar period (see Table K or J of §20.2031–7(d)(6)). T equals the time period in years from the decedent's date of death through the last day of the trust year immediately before the year for which the periodic addition is first payable.

(C) *Amount includible*. The amount includible in the gross estate in the case of a graduated retained interest is the sum of the base amount and the *corpus* amount for each year for which a periodic addition is first payable. The sum of these amounts represents the amount of trust principal that would be necessary to generate the annual payments that would have been paid to the decedent if the decedent had survived and had continued to receive the graduated retained interest. The amount of trust *corpus* includible in a decedent's gross estate under this section, however, shall not exceed the fair market value of the trust *corpus* on the decedent's date of death. The provisions of this section also apply to graduated retained interests in transferred property not held in trust.

(iv) *Examples*. The application of paragraphs (c)(2)(i), (c)(2)(ii), and (c)(2)(iii) of this section is illustrated in the following examples:

* * * * *

Example 7. (i) On November 1, year N, D transfers assets valued at $2,000,000 to a GRAT. Under the terms of the GRAT, the trustee is to pay to D an annuity for a 5-year term that is a qualified interest described in section 2702(b). The annuity amount is to be paid annually at the end of each trust year, on October 31st. The first annual payment is to be $100,000. Each succeeding payment is to be 120 percent of the amount paid in the preceding year. Income not distributed in any year is to be added to principal. If D dies during the 5-year term, the payments are to be made to D's estate for the balance of the GRAT term. At the end of the 5-year term, the trust is to terminate and the corpus is to be distributed to C, D's child. D dies on January 31st of the third year of the GRAT term. On the date of D's death, the value of the trust corpus is $3,200,000, the section 7520 interest rate is 6.8 percent, and the adjustment factor from Table K of §20.2031–7 is 1.0000. D's executor does not elect to value the gross estate as of the alternate valuation date pursuant to section 2032.

(ii) The amount includible in D's gross estate under section 2036(a)(1) as described in paragraph (c)(2)(iii)(C) of this section is determined and illustrated as follows:

A GRAT Year	*B* Annual Annuity Payment	*C* Periodic Addition	*D* Required Principal: C x Adj. Factor / 0.068	*E* Deferral Period: Death to GRAT Year	*F* Present Value Factor: 1/(1+.068)^E	*G* Corpus or Base Amount At Death: D x F
3	144,000	n/a	2,117,647	n/a	n/a	2,117,647
4	172,800	28,800	423,529	0.747945	0.951985	403,193
5	207,360	34,560	508,235	1.747945	0.891372	453,026
					Total:	2,973,866

(iii) Specifically:

(A) *Column A*. First, determine the year of the trust term during which the decedent's death occurs, and the number of subsequent years remaining in the trust term for which the decedent retained or reserved an interest. In this example, D dies during year 3, with two additional years remaining in the term.

(B) *Column B*. Under the formula specified in the trust, the annuity payment to be made on October 31st of the 3rd year of the trust term is $144,000. Using that same formula, determine the annuity amounts for years 4 and 5.

(C) *Column C*. Determine the periodic addition for year 4 and year 5 by subtracting the annuity amount for the preceding year from the annuity amount for that year; the periodic addition for that year is the amount of the increase in the annuity amount for that year.

(D) *Columns D through G for year 3*. For the year of the decedent's death (year 3), determine the principal required to produce the annuity amount (Column D) by multiplying the annuity amount (Column B) by the adjustment factor (in this case 1.0000) and by dividing the product by the applicable interest rate under section 7520. Because this is the year of decedent's death and reflects the annuity amount payable to the decedent in that year, there is no deferral, so this is also the Base Amount (the amount of *corpus* required to produce the annuity for year 3) (Column G).

(E) *Columns D through G for years 4 and 5*. For each succeeding year of the trust term during which the periodic addition will not be payable until a year subsequent to the year of the decedent's death, determine the principal required to produce the periodic addition payable for that year (Column D) by multiplying the periodic addition (Column C) by the adjustment factor and by dividing the product by the applicable interest rate under section 7520. Compute the factors to reflect the length of the deferral period (Column E) and the present value (Column F) as described in paragraph (c)(2)(iii)(B)(*3*) of this section. Multiply the amount of *corpus* in Column D by the factors in Columns E and F to determine the *Corpus* Amount for that year (Column G).

(F) *Column G total*. The sum of the amounts in Column G represents the total amount includable in the gross estate (but not in excess of the fair market value of the trust on the decedent's date of death).

(iv) An illustration of the amount of trust *corpus* (as of the decedent's death) necessary to produce the scheduled payments is as follows:

		Year 3	Year 4	Year 5	Corpus Amount
2nd Periodic Addition	$34,560	Deferral period		$453,026	$453,026
1st Periodic Addition	$28,800	Deferral period	$403,193		$403,193
Annuity in year of death	$144,000	$2,117,647			$2,117,647
Total amount (sum) included in gross estate					$2,973,866

(v) A total *corpus* amount (as defined in paragraph (c)(2)(iii)(B)(*3*) of this section) of $2,973,866 constitutes the principal required as of decedent's date of death to produce (without reducing or invading principal) the annual payments that D would have received if D had survived and had continued to receive the retained annuity. Therefore, $2,973,866 of the trust *corpus* is includible in D's gross estate under section 2036(a)(1). The remaining $226,134 of the trust *corpus* is not includible in D's gross estate under section 2036(a)(1). The result would be the same if D's retained annuity instead had been payable to D for a term of 5 years, or until D's prior death, at which time the GRAT would have terminated and the trust *corpus* would have become payable to another.

(vi) If, instead, D's annuity was to have been paid on a monthly or quarterly basis, then the periodic addition would have to be adjusted as provided in paragraph (c)(2)(iii)(B)(*3*) of this section. Specifically, in Column D of the Table for years 4 and 5 in this example, the amount of the principal required would be computed by multiplying the periodic addition by the appropriate factor from Table K or J of §20.2031–7(d)(6) before dividing as indicated and computing the amounts in Columns E through G. In addition, Column D in year 3 also would have to be so adjusted. Under the facts presented, section 2039 does not apply to include any amount in D's gross estate by reason of this retained interest. See §20.2039–1(e).

Example 8. (i) D creates an irrevocable *inter vivos* trust. The terms of the trust provide that an annuity of $10,000 per year is to be paid to D and C, D's child, in equal shares during their joint lives. On the death of the first to die of D and C, the entire $10,000 annuity is to be paid to the survivor for life. On the death of the survivor of D and C, the remainder is to be paid to another individual, F. Subsequently, D dies survived by C. On D's date of death, the fair market value of the trust is $120,000 and the section 7520 rate is 7 percent. At the date of D's death, the amount of trust *corpus* needed to produce D's annuity interest ($5,000 per year) is $71,429 ($5,000/0.07). In addition, assume the present value of C's right to receive $5,000 annually for the remainder of C's life is $40,000. The portion of the trust corpus includible in D's gross estate under section 2036(a)(1) is $102,857, determined as follows:

(ii) *Step 1*: Fair market value of *corpus*.	$120,000
(iii) *Step 2*: *Corpus* required to produce D's date of death annuity ($5,000/0.07).	$71,429
(iv) *Step 3*: *Corpus* required to produce D's annuity if D had survived C ($10,000/0.07).	$142,857
(v) *Step 4*: Present value of C's interest.	$40,000
(vi) *Step 5*: The amount determined in Step 3, reduced by the amount determined in Step 4, but not to below the amount determined in Step 2 ($142,857 - $40,000, but not less than $71,429).	$102,857
(vii) *Step 6*: The lesser of the amounts determined in Steps 5 and 1 ($102,857 or $120,000).	$102,857.

(3) *Effective/applicability dates*. * * * All but the last two sentences at the end of paragraph (c)(1)(i) of this section are applicable to the estates of decedents dying after August 16, 1954. The first, second, and sixth sentences in paragraph (c)(2)(i) of this section and all but the introductory text, *Example 7*, and *Example 8* of paragraph (c)(2)(iv) of this section are applicable to the estates of decedent's dying on or after July 14, 2008. Paragraph (b)(1)(ii) of this section, the last two sentences at the end of paragraph (c)(1)(i) of this section, *Example 1* of paragraph (c)(1)(ii) of this section, the third, fourth, and fifth sentences in paragraph (c)(2)(i) of this section; paragraph (c)(2)(ii) of this section; paragraph (c)(2)(iii) of this section; and the introductory text, *Example 7*, and *Example 8* of paragraph (c)(2)(iv) of this section are applicable to the estates of decedents dying on or after November 8, 2011.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved October 27, 2011.

Emily S. McMahon,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 7, 2011, 8:45 a.m., and published in the issue of the Federal Register for November 8, 2011, 76 F.R. 69126)

Section 3121.—Definitions

26 CFR 3121(b)(3)–1: Family employment.

T.D. 9554

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 31 and 301

Extending Religious and Family Member FICA and FUTA Exceptions to Disregarded Entities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations amending 26 CFR parts 31 and 301. These regulations extend the exceptions from taxes under the Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA") under sections 3121(b)(3) (concerning individuals who work for certain family members), 3127 (concerning members of religious faiths), and 3306(c)(5) (concerning persons employed by children and spouses and children under 21 employed by their parents) of the Internal Revenue Code ("Code") to entities that are disregarded as separate from their owners for federal tax purposes. The temporary regulations also clarify the existing rule that the owners of disregarded entities, except for qualified subchapter S subsidiaries, are responsible for backup withholding and related information reporting requirements under section 3406. The text of the temporary regulations also serves as the text of the proposed regulations (REG–136565–09) set forth in the notice of proposed rulemaking on this subject in this issue of the **Bulletin**.

DATES: *Effective Date:* These regulations are effective on November 1, 2011.

Applicability Date: For dates of applicability see §§31.3121(b)(3)–1T(e), 31.3127–1T(d), 31.3306(c)(5)–1T(e), 301.7701–2T(e)(5).

FOR FURTHER INFORMATION CONTACT: Joseph Perera (202) 622–6040 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document contains final and temporary regulations amending the Employment Tax Regulations (26 CFR part 31) and the Procedure and Administration Regulations (26 CFR part 301) to extend the FICA and FUTA exceptions for family members and religious sect members to certain entities that are disregarded as separate from their owners for federal tax purposes under §301.7701–2(c). Section 301.7701–2(c)(2)(i) provides that generally, except as otherwise provided, a business entity that has a single owner and is not a corporation under §301.7701–2(b) is disregarded as an entity separate from its owner. Prior to 2009, single-member entities disregarded as separate from their owners were generally disregarded for employment taxes and certain other requirements of law arising under subtitle C. An employer is generally defined as the person for whom an individual performs services as an employee. Sections 3401(d), 3121(d), and 3306(a). Prior to 2009, the owner

of the disregarded entity was treated as the employer for purposes of employment tax liabilities and all other employment tax obligations related to wages paid to employees performing services for the disregarded entity.

Recent changes to §301.7701–2(c)(2)(iv) provide that, with respect to wages paid after December 31, 2008, a disregarded entity is treated as a separate entity for purposes of employment taxes imposed under Subtitle C and related reporting requirements. In addition, the separate entity is treated as a corporation for purposes of employment taxes imposed under Subtitle C and related reporting requirements. Therefore, the entity, rather than the owner, is considered to be the employer of any individual performing services for the entity.

Sections 3111 and 3301 of the Code impose FICA and FUTA taxes, respectively, on the employer in an amount equal to a percentage of the wages paid by that employer with respect to employment. Under section 3101, FICA tax is also imposed on the employee. Sections 3121(b) and 3306(c) define employment for FICA and FUTA purposes as any service, of whatever nature, performed by an employee for the person employing him. However, there are some services which are explicitly excepted from the definition of employment. For example, section 3121(b)(3)(A) provides that service performed by a child under the age of 18 in the employ of his father or mother is not considered employment for FICA purposes. Section 3121(b)(3)(B) provides that service performed by an individual under the age of 21 employed by his father or mother, or performed by an individual employed by his spouse or son or daughter (subject to certain conditions) for domestic service in a private home of the employer is not considered employment for FICA purposes. Section 3306(c)(5) provides that service performed by an individual in the employ of his son, daughter, or spouse, and service performed by a child under the age of 21 in the employ of his father or mother are not considered employment for FUTA purposes.

Prior to the recent changes to §301.7701–2(c), the services a family member performed for a disregarded entity wholly owned by another family member could qualify for the exceptions under sections 3121(b)(3) and 3306(c)(5) if all the requirements were satisfied, as the individual family member owner was treated as the employer. However, due to the recent changes to the regulations, family members can no longer qualify for the FICA and FUTA exceptions that apply to family employment because §301.7701–2(c)(2)(iv) regards the disregarded entity as a separate entity and treats the separate entity as a corporation for employment tax purposes. Sections 31.3121(b)(3)–1(c) and 31.3306(c)(5)–1(c) explicitly state that services performed in the employ of a corporation are not within the exceptions from employment that apply because of the existence of a family relationship between the employee and the individual employing him.

Section 3127 provides an exception from FICA taxes where both the employer and the employee are members of a religious faith opposed to participation in the Social Security Act. Both the employer and the employee must be members of a recognized religious sect and both must have filed and had approved an application certifying that they are members of a qualifying religious faith. Prior to the recent changes made to §301.7701–2(c), service performed by a member of a qualifying religious sect for a disregarded entity wholly owned by another member of a qualifying religious sect could qualify for this exception as the individual sect member was considered to be the employer. However, as a result of the recent changes to §301.7701–2(c)(2)(iv), the disregarded entity is regarded as a separate entity for employment tax purposes and the separate entity is treated as a corporation. As a corporation, the entity cannot be considered a member of a qualifying religious sect. Therefore, the exception cannot apply, as the employer would not be a member of a qualifying religious sect.

Section 301.7701–2(c)(2)(iv) treats disregarded entities as corporations for employment tax purposes. Such entities cannot qualify for the FICA and FUTA exceptions contained in sections 3121(b)(3), 3127, and 3306(c)(5) because the individual owner is no longer considered the employer. The IRS and the Treasury Department did not intend to render these exceptions inapplicable to disregarded entities that were eligible for the exceptions prior to the effective date of the new regulations in §301.7701–2(c). The inability of these entities to benefit from the exceptions for family employees and members of religious faiths has an adverse impact on small businesses. Accordingly, a change is necessary to correct this problem.

While §301.7701–2(c)(2)(iv) treats an entity that is disregarded as an entity separate from its owner as a corporation for employment tax purposes, such entity remains disregarded for backup withholding and related information reporting purposes. The preamble to Treasury Decision 9356, 2007–2 C.B. 675, which finalized the changes to §301.7701–2(c) indicates that these regulations do not apply to reportable payments under section 3406. Accordingly, the owner of the disregarded entity is responsible for any backup withholding that is required with respect to reportable payments considered made by the owner rather than the disregarded entity, other than a qualified subchapter S subsidiary. However, the final regulations themselves do not explicitly state that such disregarded entities are not responsible for information reporting and backup withholding. This has caused some confusion as to the responsible party for filing information returns for reportable payments and related backup withholding requirements. Therefore, language has been added to these regulations to clarify the existing rules with respect to backup withholding and related information reporting responsibilities.

Explanation of Provisions

The temporary regulations would allow certain disregarded entities under §301.7701–2 to qualify for the FICA and FUTA exceptions of sections 3121(b)(3), 3127 and 3306(c)(5). The disregarded entity will continue to be treated as a corporation for all employment tax purposes, except the entity will be disregarded for the limited purposes of applying the FICA and FUTA exceptions found in sections 3121(b)(3), 3127 and 3306(c)(5). For purposes of applying these exceptions only, the owner of the disregarded entity will be treated as the employer and the employee will be considered to be an employee of the owner. Additionally, the regulations clarify the existing rule that disregarded entities under §301.7701–2 are not responsible for backup withholding

and information reporting of reportable payments under section 3406. Rather, the owner of a disregarded entity under §301.7701–2 is responsible for backup withholding and information reporting of reportable payments under section 3406. This does not change the existing rule.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Joseph Perera, Office of Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 301 are amended as follows:

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

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3121(b)(3)–1 is amended by revising paragraph (c) and adding paragraphs (d) and (e) to read as follows:

§31.3121(b)(3)–1 Family employment.

* * * * *

(c) [Reserved]. For further guidance, *see* §31.3121(b)(3)–1T(c).

(d) [Reserved]. For further guidance, *see* §31.3121(b)(3)–1T(d).

(e) [Reserved]. For further guidance, *see* §31.3121(b)(3)–1T(e).

Par. 3. Section 31.3121(b)(3)–1T is added to read as follows:

§31.3121(b)(3)–1T Family employment (temporary).

(a) [Reserved]. For further guidance, *see* §31.3121(b)(3)–1(a).

(b) [Reserved]. For further guidance, *see* §31.3121(b)(3)–1(b).

(c) Services performed in the employ of a corporation are not within the exceptions, except as provided in paragraph (d). Services performed in the employ of a partnership are not within the exception unless the requisite family relationship exists between the employee and each of the partners comprising the partnership.

(d) A disregarded entity that is treated as a corporation under §301.7701–2(c)(2)(iv)(B) of this chapter (Procedure and Administration Regulations) shall not be treated as a corporation for purposes of applying section 3121(b)(3). For purposes of applying section 3121(b)(3), the owner of the disregarded entity will be treated as the employer.

(e) Paragraphs (c) and (d) of this section apply with respect to wages paid on or after November 1, 2011. However, taxpayers may apply paragraphs (c) and (d) of this section to wages paid on or after January 1, 2009.

(f) *Expiration date*. The applicability of paragraphs (c) and (d) of this section expires on or before October 31, 2014.

Par. 4. Section 31.3127–1T is added to subpart B to read as follows:

§31.3127–1T Exemption for employers and their employees where both are members of religious faiths opposed to participation in Social Security Act programs (temporary).

(a) If an employer (or if the employer is a partnership, each partner therein) and their employee are members of a recognized religious sect or division described in section 1402(g)(1) of the Code, both the employer and employee adhere to the tenets and teachings of that sect, and both the employer and employee have filed and had approved applications under section 3127(b) for exemption from the taxes imposed by sections 3111 and 3101 then the employer is exempt from taxes imposed by section 3111 with respect to the wages paid to the eligible employee, and the employee is exempt from the taxes imposed by section 3101 with respect to the wages paid by that employer.

(b) Services performed in the employ of a corporation are not within the exception, except as provided in paragraph (c) of this section.

(c) A disregarded entity that is treated as a corporation under §301.7701–2(c)(2)(iv)(B) of this chapter (Procedure and Administration Regulations) shall not be treated as a corporation for purposes of applying section 3127. For purposes of section 3127, the owner of the disregarded entity will be treated as the employer and the payor of the employee's wages.

(d) This section applies with respect to wages paid on or after November 1, 2011. However, taxpayers may apply this section to wages paid on or after January 1, 2009.

(e) *Expiration date*. The applicability of this section expires on or before October 31, 2014.

Par. 5. Section 31.3306(c)(5)–1 is amended by revising paragraph (c) and adding paragraphs (d) and (e) to read as follows:

§31.3306(c)(5)–1 Family Employment.

* * * * *

(c) [Reserved]. For further guidance, *see* §31.3306(c)(5)–1T(c).

(d) [Reserved]. For further guidance, *see* §31.3306(c)(5)–1T(d).

(e) [Reserved]. For further guidance, *see* §31.3306(c)(5)–1T(e).

Par. 6. Section 31.3306(c)(5)–1T is added to read as follows:

§31.3306(c)(5)–1T Family employment (temporary).

(a) [Reserved]. For further guidance, *see* §31.3306(c)(5)–1(a).

(b) [Reserved]. For further guidance, *see* §31.3306(c)(5)–1(b).

(c) Services performed in the employ of a corporation are not within the exception, except as provided in paragraph (d) of this section. Services performed in the

employ of a partnership are not within the exception unless the requisite family relationship exists between the employee and each of the partners comprising the partnership.

(d) A disregarded entity that is treated as a corporation under §301.7701–2(c)(2)(iv)(B) of this chapter (Procedure and Administration Regulations) shall not be treated as a corporation for purposes of applying section 3306(c)(5). For purposes of applying section 3306(c)(5), the owner of the disregarded entity will be treated as the employer.

(e) Paragraphs (c) and (d) of this section apply with respect to wages paid on or after November 1, 2011. However, taxpayers may apply paragraphs (c) and (d) of this section to wages paid on or after January 1, 2009.

(f) *Expiration date*. The applicability of paragraphs (c) and (d) of this section expires on or before October 31, 2014.

PART 301—PROCEDURE AND ADMINISTRATION.

Par. 7. The authority citation for part 301 continues to read in part as follows:

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

Par. 8. Section 301.7701–2 is amended by:

1. Revising paragraph (c)(2)(iv)(A).

2. Redesignating paragraph (c)(2)(iv)(C) as paragraph (c)(2)(iv)(D) and adding new paragraph (c)(2)(iv)(C).

§301.7701–2 Business entities; definitions.

* * * * *

(c) * * *

(2) * * *

(iv) * * *

(A) [Reserved]. For further guidance, *see* §301.7701–2T(c)(2)(iv)(A).

* * * * *

(C) [Reserved]. For further guidance, *see* §301.7701–2T(c)(2)(iv)(C).

* * * * *

Par. 9. Section 301.7701–2T is added to read as follows:

§301.7701–2T Business entities; definitions (temporary).

(a) through (c)(2)(iv) [Reserved]. For further guidance, see §301.7701–2(a) through (c)(2)(iv).

(A) *In general*. Section §301.7701–2(c)(2)(i) (relating to certain wholly owned entities) does not apply to taxes imposed under Subtitle C—Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24 and 25 of the Internal Revenue Code). However, §301.7701–2(c)(2)(i) does apply to withholding requirements imposed under section 3406 (backup withholding). The owner of a business entity that is disregarded under §301.7701–2 is subject to the withholding requirements imposed under section 3406 (backup withholding). Section 301.7701–2(c)(2)(i) also applies to taxes imposed under Subtitle A, including Chapter 2—Tax on Self Employment Income. The owner of an entity that is treated in the same manner as a sole proprietorship under §301.7701–2(a) will be subject to tax on self-employment income.

(B) [Reserved]. For further guidance, see §301.7701–2(c)(2)(iv)(B).

(C) *Exceptions*. For exceptions to the rule in §301.7701–2(c)(2)(iv)(B), see sections 31.3121(b)(3)–1(d), 31.3127–1(c), and 31.3306(c)(5)–1(d).

(D) through (e)(4) [Reserved]. For further guidance, see §301.7701–2(c)(2)(iv)(D) through (e)(4).

(5) Paragraphs (c)(2)(iv)(A) and (c)(2)(iv)(C) of this section apply to wages paid on or after November 17, 2011. For rules that apply to paragraph (c)(2)(iv)(A) of this section before November 17, 2011, see 26 CFR part 301 revised as of April 1, 2009. However, taxpayers may apply paragraphs (c)(2)(iv)(A) and (c)(2)(iv)(C) of this section to wages paid on or after January 1, 2009.

(e)(6) through (e)(7) [Reserved]. For further guidance, see §301.7701–2(e)(6) through (e)(7).

(8) *Expiration Date*. The applicability of paragraphs (c)(2)(iv)(A) and (c)(2)(iv)(C) of this section expires on or before November 14, 2014.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Approved November 19, 2011.

Michael Mundaca,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on November 9, 2011, 8:45 a.m., and published in the issue of the Federal Register for November 10, 2011, 76 F.R. 70057)

Part III. Administrative, Procedural, and Miscellaneous

Proposed Method of Accounting for OID on a Pool of Credit Card Receivables

Notice 2011–99

Purpose

This notice provides a proposed revenue procedure in which the Internal Revenue Service ("IRS") will allow a taxpayer to use a simplified method of accounting to allocate original issue discount ("OID") on a pool of credit card receivables to an accrual period. The method generally allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of the stated redemption price at maturity ("principal") of the pool that is paid by cardholders during the period. The method is intended to reduce administrative burdens and controversy for taxpayers and the IRS in computing OID accruals on a pool of credit card receivables under § 1272(a)(6) of the Internal Revenue Code. This notice also requests comments on the proposed revenue procedure.

Request for Comments

The Treasury Department and the IRS request comments on all aspects of the proposed revenue procedure in this notice. Consideration will be given to any written public comments that are submitted on or before March 16, 2012. A signed original and eight (8) copies of public comments should be sent by mail to the IRS at CC:PA:LPD:PR (IRS Notice 2011–99), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Public comments also may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attn: CC:PA:LPD:PR (IRS Notice 2011–99). Comments also may be transmitted electronically via the following e-mail address: *Notice.Comments@irscounsel.treas.gov*. Please include "Notice 2011–99" in the subject line of any electronic communications. All comments will be available for public inspection and copying.

Drafting Information

The principal author of this notice is Charles W. Culmer of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Charles W. Culmer at (202) 622–3950 (not a toll-free call).

PROPOSED REVENUE PROCEDURE

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.601: Rules and regulations.
(Also Part I, § 1272(a)(6))

Rev. Proc. [XXXX–XX]

SECTION 1. PURPOSE

This revenue procedure allows a taxpayer to use a safe harbor method of accounting for original issue discount ("OID") on a pool of credit card receivables for purposes of § 1272(a)(6) of the Internal Revenue Code—the "proportional method." The proportional method generally allocates to an accrual period an amount of unaccrued OID that is proportional to the amount of the stated redemption price at maturity ("principal") of the pool that is paid by cardholders during the period. Under certain assumptions, the proportional method as described in this revenue procedure generally produces the same results as an implementation of the method described in § 1272(a)(6). The revenue procedure also describes the exclusive procedures by which a taxpayer may obtain the Commissioner's consent to change to the proportional method.

SECTION 2. BACKGROUND

.01 A debt instrument is issued with OID if the instrument's issue price is less than its stated redemption price at maturity. Section 1273(a)(1). Under § 1.1273–1(b) of the Income Tax Regulations, the stated redemption price at maturity of a debt instrument is the sum of all payments provided by the debt instrument other than payments of qualified stated interest. In general, qualified stated interest is stated interest that is unconditionally payable in cash, or that is constructively received under § 451, at least annually at a single fixed rate. Section 1.1273–1(c).

.02 Accruals of OID generally are taken into account over the term of a debt instrument using the constant yield method. *See* § 1272(a)(3) and § 1.1272–1. The Code provides special rules, however, for certain debt instruments for which the principal is subject to acceleration. *See* § 1272(a)(6). Under § 1272(a)(6), if the principal on a debt instrument is subject to acceleration, OID accruals are determined based on a prepayment assumption and a formula involving the present value of all remaining payments under the debt instrument as of the close of the accrual period, payments during the accrual period of amounts included in the stated redemption price at maturity of the debt instrument, and the adjusted issue price of the debt instrument at the beginning of the accrual period ("statutory method").

.03 The Taxpayer Relief Act of 1997 extended the rules of § 1272(a)(6) to OID on any pool of debt instruments the yield on which may be affected by reason of prepayments, including a pool of credit card receivables. *See* Pub. L. 105–34, § 1004(a), 1997–4 C.B. 1, 125. However, unlike the debt instruments previously subject to § 1272(a)(6), the balance of a pool of credit card receivables can be increased, as well as decreased, from one accrual period to the next, which adds complexity in applying the rules of § 1272(a)(6).

.04 The Internal Revenue Service ("IRS") has challenged the methods of accounting for OID on pools of credit card receivables adopted by some taxpayers as not clearly reflecting income. *See*, *for example*, *Capital One Financial Corp. v. Commissioner*, 133 T.C. 136 (2009) (holding, in relevant part, that the model used by the taxpayer for computing OID accruals under § 1272(a)(6) was a reasonable method after some modifications by the court).

.05 The proportional method as described in this revenue procedure is intended to reduce administrative burdens and controversy for taxpayers and the IRS

in computing OID accruals on a pool of credit card receivables under § 1272(a)(6). Under certain assumptions, the proportional method is a simplified method of calculation that generally produces the same results as an implementation of the statutory method.

.06 Certain credit card fees are treated as creating or increasing the amount of OID on the pool of credit card receivables to which the fees relate. *See*, *for example*, Rev. Proc. 2004–33, 2004–1 C.B. 989 (Commissioner will allow a taxpayer to treat late fees as OID). However, certain fees do not create or increase the amount of OID on the pool of credit card receivables to which the fees relate. *See*, *for example*, Rev. Rul. 2004–52, 2004–1 C.B. 973 (credit card annual fees do not result in OID).

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer if—

.01 The taxpayer issues credit cards allowing cardholders to access a revolving line of credit established by the taxpayer to purchase goods and services, or to obtain cash advances;

.02 For federal income tax purposes, the taxpayer does not treat the credit card purchase transactions of its cardholders as creating debt that is given in consideration for the sale or exchange of property;

.03 The taxpayer maintains one or more pools of receivables with respect to such credit cards; and

.04 In the case of a taxpayer that maintains more than one pool of credit card receivables, the manner in which pools are established and maintained does not achieve a result that is unreasonable in light of the purposes of §§ 1271 through 1275.

SECTION 4. APPLICATION

.01 The proportional method of accounting described in section 5 of this revenue procedure is a permissible method for use by a taxpayer within the scope of this revenue procedure to account for OID on a pool of credit card receivables described in section 3 of this revenue procedure. If the proportional method is used by a taxpayer to account for any pool of credit card receivables, the method must be used for every pool of credit card receivables described in section 3 of this revenue procedure and held by that taxpayer. If the proportional method is used for more than one such pool, separate data for each pool must be kept, and the computations must be made separately based on the data for each pool.

.02 A taxpayer that wants to change its method of accounting to the proportional method must use the automatic change in method procedures of Rev. Proc. 2011–14, 2011–4 I.R.B. 330, or its successor, to make the change. *See* section 8 of this revenue procedure. If a taxpayer changes to the proportional method, the unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the receivables in the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the receivables. See section 5.02(2) of this revenue procedure. If a taxpayer does not already have a method of accounting for OID on any pool of credit card receivables, the taxpayer may adopt the proportional method by using it on a timely-filed federal income tax return for the first taxable year the taxpayer must account for OID on a pool of credit card receivables. A taxpayer may use the proportional method for the taxpayer's first taxable year that begins on or after the effective date described in section 7 of this revenue procedure.

SECTION 5. PROPORTIONAL METHOD OF ACCOUNTING

This section 5 describes the proportional method of accounting for OID on a pool of credit card receivables. Under the method—

.01 The required computations must be made monthly. Thus, the computation period referred to below is a calendar month (or that portion of a month that falls within a short taxable year). A taxpayer that changes its method of accounting to the proportional method must make the required computations for each month in the year of change by the due date for the taxpayer's timely filed (including any extension) original federal income tax return implementing the change in method of accounting for the year of change.

.02 At the beginning of each computation period, the taxpayer must determine the following information for each pool of credit card receivables:

(1) The stated redemption price at maturity as of the beginning of the period ("Beginning SRPM"), which is equal to the aggregate balance owed on all credit card receivables included in the pool at the beginning of such period, other than amounts representing charges or fees that are not properly treated as OID (such as finance charges that are qualified stated interest).

(2) The unaccrued OID as of the beginning of the period ("Beginning OID"), which is equal to the OID with respect to the credit card receivables included in the pool at the beginning of such period that has not previously been taken into income.

.03 During each computation period, the taxpayer must determine for each pool of credit card receivables the sum of the payments during the period of amounts that reduce the Beginning SRPM for the period ("SRPM Payments") (equivalently, total payments less amounts that are not included in SRPM, such as charges or fees that are not properly treated as OID).

.04 For each computation period, the taxpayer must compute the OID allocated to the period ("Monthly OID") and include this amount in income for the period. Monthly OID is the product of (1) the Beginning OID multiplied by (2) the quotient of the SRPM Payments divided by the Beginning SRPM.

.05 The formula in section 5.04 of this revenue procedure can be restated as follows:

M_OID = BEG_OID * (SRPM_P / BEG_SRPM),
where

M_OID	= Monthly OID;
BEG_OID	= Beginning OID;
SRPM_P	= SRPM Payments;
BEG_SRPM	= Beginning SRPM.

.06 For purposes of determining the Beginning SRPM and Beginning OID for a period, the taxpayer should take into account the following items:

(1) The charges and fees relating to the pool for the preceding period that are properly treated as OID;

(2) Credit card accounts transferred into the pool from another one of the taxpayer's pools during the preceding period, including any unaccrued OID attributable to the accounts;

(3) Credit card accounts transferred out of the pool into another one of the taxpayer's pools during the preceding period, including any unaccrued OID attributable to the accounts; and

(4) Credit card accounts written off during the preceding period, including any unaccrued OID attributable to the accounts.

.07 Section 1.6001–1(a) of the Procedure and Administration Regulations provides that any person subject to tax under subtitle A of the Internal Revenue Code shall keep such permanent books of account or records to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax. In order to satisfy the recordkeeping requirements of § 6001 and the regulations thereunder, a taxpayer that uses the proportional method of accounting should maintain records supporting all aspects of its method, including, but not limited to, the computations described in section 5 of this revenue procedure.

SECTION 6. EXAMPLES

.01 Example 1. (1) On December 1, for the taxpayer's single pool of credit card receivables, the Beginning SRPM is $100,000,000, and the Beginning OID is $1,000,000. During December, the taxpayer receives SRPM payments of $11,000,000 with respect to the pool.

(2) For December, the taxpayer computes Monthly OID for the pool in the amount of $110,000 ($1,000,000 * ($11,000,000 / $100,000,000)).

.02 Example 2. (1) The facts are the same as in Example 1 except that, during November, additional transactions occur that affect the Beginning SRPM and Beginning OID for December. During November, cardholders incur additional fees of $100,000 that are properly treated as OID, and the taxpayer writes off additional credit card accounts whose aggregate balance at the time of the write-offs is $50,000. The taxpayer determines that the unaccrued OID attributable to the additional written-off accounts is $1,000. As a result, on December 1, the Beginning SRPM is $100,050,000 ($100,000,000 + $100,000 - $50,000), and the Beginning OID is $1,099,000 ($1,000,000 + $100,000 - $1,000).

(2) For December, the taxpayer computes Monthly OID for the pool in the amount of $120,830 ($1,099,000 * ($11,000,000 / $100,050,000)).

SECTION 7. EFFECTIVE DATE

[RESERVED]

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011–14 is modified to add new section 31.02 to the APPENDIX, to read as follows:

SECTION 31.02. Proportional method of accounting for OID on a pool of credit card receivables

(1) *Description of change*. This change applies to a taxpayer that wants to change to the proportional method of accounting for OID on a pool of credit card receivables as described in Rev. Proc. xxxx–xx. Under Rev. Proc. xxxx–xx, a taxpayer may use the proportional method of accounting for the taxpayer's first taxable year that begins on or after the effective date described in section 7 of Rev. Proc. xxxx–xx.

(2) *Manner of making change*. This change is made on a cut-off basis. Accordingly, a § 481(a) adjustment is neither required nor permitted. The unaccrued OID for the pool as of the beginning of the first period in the year of change is equal to the unaccrued OID for the receivables in the pool as of the end of the preceding year under the taxpayer's previous method of accounting for the receivables. See section 2.06 of this revenue procedure for more information regarding a cut-off basis.

(3) *Designated automatic accounting method change number*. The designated automatic accounting method change number for a change under section 31.02 of this APPENDIX is "XXX." See section 6.02(4) of this revenue procedure.

(4) *Contact information*. For further information regarding this section, please contact Charles W. Culmer at (202) 622–3950 (not a toll-free call).

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Charles W. Culmer of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact Charles W. Culmer at (202) 622–3950 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part 1, §§ 165, 1.165–8(c).)

Rev. Proc. 2011–58

SECTION 1. PURPOSE

This revenue procedure modifies the definition of a qualified loss in section 4.02 of Rev. Proc. 2009–20, 2009–1 C.B. 749, to address certain situations in which the death of a lead figure (as described in section 4.01 of Rev. Proc. 2009–20) has foreclosed the possibility of criminal charges. This revenue procedure also makes a conforming modification to the definition of discovery year in section 4.04 of Rev. Proc. 2009–20.

SECTION 2. BACKGROUND

.01 Rev. Rul. 2009–9, 2009–1 C.B. 735, describes the proper income tax treatment for losses resulting from certain fraudulent investment arrangements, including so-called Ponzi schemes.

.02 Rev. Proc. 2009–20 provides an optional safe harbor allowing certain investors to claim a theft loss deduction under § 165 of the Internal Revenue Code for

qualified losses from certain fraudulent investment schemes. Under section 4.02 of Rev. Proc. 2009–20, a qualified loss is a loss from a specified fraudulent arrangement (defined in section 4.01) for which authorities have charged the lead figure by indictment, information, or criminal complaint with a crime that meets the definition of theft for purposes of § 165.

.03 Since publication of Rev. Proc. 2009–20, the deaths of some lead figures in Ponzi schemes have foreclosed authorities' ability to charge them with criminal theft. Qualified investors in these cases are unable to meet the definition of a qualified loss in section 4.02 of Rev. Proc. 2009–20 and therefore are precluded from using the optional safe harbor, solely because of the death of a lead figure. This revenue procedure expands the definition of qualified loss in Rev. Proc. 2009–20 to address these cases.

.04 This revenue procedure also clarifies that the terms "indictment," "information," and "criminal complaint" in section 4.02 of Rev. Proc. 2009–20 have meanings similar to the use of those terms in the Federal Rules of Criminal Procedure.

SECTION 3. SCOPE

This revenue procedure applies to qualified investors within the meaning of section 4.03 of Rev. Proc. 2009–20.

SECTION 4. APPLICATION

.01 Section 4.02 of Rev. Proc. 2009–20 is modified to read as follows:

.02 *Qualified loss*. A qualified loss is a loss resulting from a specified fraudulent arrangement in which, as a result of the conduct that caused the loss—

(1) A lead figure was charged by indictment or information (see, for example, Fed. R. Crim. P. 7) under state or federal law with the commission of fraud, embezzlement, or a similar crime that, if proven, would meet the definition of theft for purposes of § 165 of the Internal Revenue Code and § 1.165–8(d) of the Income Tax Regulations under the law of the jurisdiction in which the theft occurred, and the indictment or information has not been withdrawn or dismissed (other than because of the death of the lead figure);

(2) A lead figure was the subject of a state or federal criminal complaint (see, for example, Fed. R. Crim. P. 3) alleging the commission of a crime described in section 4.02(1) of this revenue procedure, the complaint has not been withdrawn or dismissed (other than because of the death of the lead figure), and either—

(a) The complaint alleged an admission by the lead figure, or the execution of an affidavit by that person admitting the crime; or

(b) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen; or

(3) A lead figure, or an associated entity involved in the specified fraudulent arrangement, was the subject of one or more civil complaints (see, for example, Fed. R. Civ. P. 3, 7) or similar documents (such as a notice or order instituting administrative proceedings or other document the Internal Revenue Service designates) that a state or federal governmental entity filed with a court or in an administrative agency enforcement proceeding, and—

(a) The civil complaint or similar documents together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement, as described in section 4.01 of this revenue procedure, conducted by the lead figure;

(b) The death of the lead figure precludes a charge by indictment, information, or criminal complaint against that lead figure as described in section 4.02(1) or (2) of this revenue procedure; and

(c) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen.

.02 Section 4.04 of Rev. Proc. 2009–20 is modified to read as follows:

.04 *Discovery year*. A qualified investor's discovery year is the investor's taxable year in which—

(1) The indictment, information, or complaint described in section 4.02(1) or (2) of this revenue procedure is filed; or

(2) The complaint or similar document described in section 4.02(3) of this revenue procedure is filed, or the death of the lead figure occurs, whichever is later.

SECTION 4. EFFECTIVE DATE

This revenue procedure applies to losses for which the discovery year is a taxable year beginning after December 31, 2007.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2009–20 is modified.

DRAFTING INFORMATION

The principal author of this revenue procedure is Justin G. Meeks of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Meeks at (202) 622–5020 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Extending Religious and Family Member FICA and FUTA Exceptions to Disregard Entities

REG–136565–09

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9554) to extend the exceptions from taxes under the Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA") under sections 3121(b)(3), 3127, and 3306(c)(5) to entities that are disregarded as separate from their owners for federal tax purposes. The temporary regulations also clarify the existing rule that the owners of disregarded entities, except for qualified subchapter S subsidiaries, are responsible for backup withholding and related information reporting requirements under section 3406. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by January 30, 2012.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–136565–09), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. to 4 p.m. to CC:PA:LPD:PR (REG–136565–09), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave. N.W., Washington, DC. Alternatively, taxpayers may submit electronic comments via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–136565–09).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Joseph Perera, at (202) 622–6040; concerning submissions of comments or requests for a hearing, Oluwafunmilayo (Funmi) Taylor at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin contain amendments to Employment Tax Regulations (26 CFR Part 31) and the Procedure and Administration Regulations (26 CFR Part 301). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations. Generally, the regulations allow certain disregarded entities under §301.7701–2 that are treated as corporations for employment tax purposes, to qualify for the FICA and FUTA exceptions of sections 3121(b)(3), 3127, and 3306(c)(5) by treating the owner of the disregarded entity as the employer for purposes of applying those sections. Additionally, the regulations clarify the existing rule that the owners of disregarded entities, other than qualified subchapter S subsidiaries are responsible for backup withholding and related information reporting requirements on reportable payments.

Proposed Effective/ Applicability Date:

The regulations, as proposed, apply to wages paid on or after November 1, 2011.

However, the rules in these proposed regulations may be relied on by taxpayers for wages paid after December 31, 2008.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be made available for public inspection and copying.

Drafting Information

The principal author of these regulations is Joseph Perera, Office of Associate Chief Counsel (Tax Exempt & Government Entities).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 301 are amended as follows:

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

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3121(b)(3)–1 is amended by:

1. Revising paragraph (c).
2. Adding paragraphs (d) and (e).

The revision and addition read as follows:

§31.3121(b)(3)–1 Family Employment

* * * * *

(c) [The text of the proposed amendment to §31.3121(b)(3)–1(c) is the same as the text of §31.3121(b)(3)–1T(c) published elsewhere in this issue of the Bulletin].

(d) [The text of the proposed amendment to §31.3121(b)(3)–1(d) is the same as the text of §31.3121(b)(3)–1T(d) published elsewhere in this issue of the Bulletin].

(e) [The text of the proposed amendment to §31.3121(b)(3)–1(e) is the same as the text of §31.3121(b)(3)–1T(e) published elsewhere in this issue of the Bulletin].

Par. 3. Section 31.3127–1 is added to read as follows:

§31.3127–1 Exceptions for employers and their employees where both are members of religious faiths opposed to participation in Social Security Act programs.

[The text of the proposed §31.3127–1 is the same as the text of §31.3127–1T published elsewhere in this issue of the Bulletin].

Par. 4. Section 31.3306(c)(5)–1 is amended by:

1. Revising paragraph (c).
2. Adding paragraphs (d) and (e).

The revision and addition read as follows:

§31.3306(c)(5)–1 Family Employment

* * * * *

(c) [The text of the proposed amendment to §31.3306(c)(5)–1(c) is the same as the text of §31.3306(c)(5)–1T(c) published elsewhere in this issue of the Bulletin].

(d) [The text of the proposed amendment to §31.3306(c)(5)–1(d) is the same as the text of §31.3306(c)(5)–1T(d) published elsewhere in this issue of the Bulletin].

(e) [The text of the proposed amendment to §31.3306(c)(5)–1(e) is the same as the text of §31.3306(c)(5)–1T(e) published elsewhere in this issue of the Bulletin].

PART 301—PROCEDURE AND ADMINISTRATION

Par. 5. The authority citation for part 301 continues to read in part as follows:

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

Par. 6. Section 301.7701–2 is amended by:

1. Revising paragraph (c)(2)(iv)(A).
2. Redesignating paragraph (c)(2)(iv)(C) as paragraph (c)(2)(iv)(D) and adding new paragraph (c)(2)(iv)(C).
3. Adding a sentence at the end of paragraph (e)(5).

The additions and revisions read as follows:

§301.7701–2 Business entities; definitions

* * * * *

(c) * * *

(2) * * *

(iv) * * *

(A) [The text of the proposed amendment to §301.7701–2(c)(2)(iv)(A) is the same as the text of §301.7701–2T(c)(2)(iv)(A) published elsewhere in this issue of the Bulletin].

(B) * * *

(C) [The text of the proposed amendment to §301.7701–2(c)(2)(iv)(C) is the same as the text of §301.7701–2T(c)(2)(iv)(C) published elsewhere in this issue of the Bulletin].

* * * * *

(e) * * *

(5) * * * [The text of the proposed amendment to §301.7701–2(e)(5) is the same as the text of §301.7701–2T(e)(5) published elsewhere in this issue of the Bulletin].

* * * * *

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 31, 2011, 8:45 a.m., and published in the issue of the Federal Register for November 1, 2011, 76 F.R. 67384)

Notice of Proposed Rulemaking

Partner's Distributive Share

REG–109564–10

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations removing §1.704–1(b)(2)(iii)(e) (the *de minimis* partner rule) because the rule may have resulted in unintended tax consequences. The proposed regulations affect partnerships and their partners.

DATES: Written or electronic comments and requests for a public hearing must be received by January 23, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–109564–10), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–109564–10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC; or sent electronically, via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–109564–10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michala Irons, at (202) 622–3050; concerning submission of comments, or requests for a public hearing, Richard Hurst, at (202) 622–2949 (TDD Telephone) (not toll-free numbers) and his e-mail address is *Richard.A.Hurst@irscounsel.treas.gov.*

SUPPLEMENTARY INFORMATION:

Background

Subchapter K is intended to permit taxpayers to conduct joint business activities through a flexible economic arrangement without incurring an entity-level tax. To achieve this goal of a flexible economic arrangement, partners are generally permitted to decide among themselves how a partnership's items will be allocated. Section 704(a) of the Internal Revenue Code provides that a partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided, be determined by the partnership agreement.

Section 704(b) places a significant limitation on the general flexibility of section

704(a). Specifically, section 704(b) provides that a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances) if the allocation to a partner under the partnership agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect. Thus, the statute provides that partnership allocations either must have substantial economic effect or must be in accordance with the partners' interests in the partnership.

Section 1.704–1(b)(2)(i) provides that the determination of whether an allocation of income, gain, loss, or deduction to a partner has substantial economic effect involves a two-part analysis that is made as of the end of the partnership taxable year to which the allocation relates. First, the allocation must have economic effect within the meaning of §1.704–1(b)(2)(ii). Second, the economic effect of the allocation must be substantial within the meaning of §1.704–1(b)(2)(iii).

For an allocation to have economic effect, it must be consistent with the underlying economic arrangement of the partners. This means that, in the event that there is an economic benefit or burden that corresponds to the allocation, the partner to whom the allocation is made must receive such economic benefit or bear such economic burden. See §1.704–1(b)(2)(ii). Generally, an allocation of income, gain, loss, or deduction (or item thereof) to a partner will have economic effect if, and only if, throughout the full term of the partnership, the partnership agreement provides: (1) for the determination and maintenance of the partners' capital accounts in accordance with §1.704–1(b)(2)(iv); (2) for liquidating distributions to the partners to be made in accordance with the positive capital account balances of the partners; and (3) for each partner to be unconditionally obligated to restore the deficit balance in the partner's capital account following the liquidation of the partner's partnership interest. In lieu of satisfying the third criterion, the partnership may satisfy the qualified income offset rules set forth in §1.704–1(b)(2)(ii)(d).

Section 1.704–1(b)(2)(iii)(a) provides as a general rule that the economic effect of an allocation (or allocations) is substantial if there is a reasonable possibility that the allocation (or allocations) will affect substantially the dollar amounts to be received by the partners from the partnership, independent of tax consequences. This section further provides that, even if the allocation affects substantially the dollar amounts, the economic effect of the allocation (or allocations) is not substantial if, at the time the allocation (or allocations) becomes part of the partnership agreement: (1) the after-tax economic consequences of at least one partner may, in present value terms, be enhanced compared to such consequences if the allocation (or allocations) were not contained in the partnership agreement, and (2) there is a strong likelihood that the after-tax economic consequences of no partner will, in present value terms, be substantially diminished compared to such consequences if the allocation (or allocations) were not contained in the partnership agreement.

Explanation of Provisions

Removal of De Minimis Partner Rule in §1.704–1(b)(2)(iii)(e)

The *de minimis* partner rule in §1.704–1(b)(2)(iii)(e) (TD 9398, 2008–1 C.B. 1143 [73 FR 28699–01]) was promulgated on May 19, 2008, as part of final regulations with respect to partners that are look-through entities. The *de minimis* partner rule provides that for purposes of applying the substantiality rules, the tax attributes of *de minimis* partners need not be taken into account and defines a *de minimis* partner as any partner, including a look-through entity that owns, directly or indirectly, less than 10 percent of the capital and profits of a partnership, and who is allocated less than 10 percent of each partnership item of income, gain, loss, deduction, and credit. The intent of the *de minimis* partner rule was to allow partnerships to avoid the complexity of testing the substantiality of insignificant allocations to partners owning very small interests in the partnership. It was not intended to allow partnerships to entirely avoid the application of the substantiality regulations if the partnership is owned by partners each of whom owns less than 10 percent of the capital or profits, and who are allocated less than 10 percent of each partnership item of income, gain, loss, deduction, and credit. The IRS and the Treasury Department have determined that the *de minimis* partner rule should be removed in order to prevent unintended tax consequences. The IRS and the Treasury Department request comments on how to reduce the burden of complying with the substantial economic effect rules, with respect to look-through partners, without diminishing the safeguards the rules provide.

Proposed Effective Date

These regulations are proposed to be effective the date final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that §553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to §7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for

the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Michala Irons, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in its development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. In §1.704–1 paragraph (b)(2)(iii)(e) is removed.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on October 24, 2011, 8:45 a.m., and published in the issue of the Federal Register for October 25, 2011, 76 F.R. 66012)

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

Announcement 2011–76

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 Service 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 Service 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 December 12, 2011, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth 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.

The Big Charity Sale, Inc.
Houston, TX
Echelon Community Services, Inc.
Washington, DC
The GT Foundation
Irvine, CA
Mandala Transformation Foundation
Rafael, CA
San Francisco Medical Research Foundation
Mill Valley, CA
Southern Utah Foundation
Cedar City, UT
Sunset Non-Profit Housing Association
Murrieta, CA

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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