

# INTERNAL REVENUE BULLETIN



## 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.

**Bulletin No. 2019-16**  
**April 15, 2019**

### Income Tax

#### **REV. RUL. 2019-10, page 1010.**

Fringe benefits aircraft valuation formula. For purposes of section 1.61-21(g) of the Income Tax Regulations, relating to the rule for valuing non-commercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the first half of 2019 are set forth.

#### **T.D. 9852, page 1010.**

Sections 1471 through 1474 of the Internal Revenue Code of 1986 (Code), commonly known as FATCA, generally require U.S. withholding agents to withhold tax on certain payments to a foreign financial institution (FFI) that has not agreed to provide the IRS with certain information regarding its United States accounts. These sections also require U.S. withholding agents to withhold tax on certain payments to a nonfinancial foreign entity (NFFE) that does not provide information about its substantial U.S. owners to withholding agents. This Treasury Decision finalizes (with limited revisions) certain proposed regulations under chapter 4 of Subtitle A (sections 1471 through 1474) of the Code. The final regulations provide compliance requirements and verification procedures for sponsoring entities of FFIs and certain NFFEs, trustees of certain trustee-documented trusts, registered deemed-compliant FFIs, and participating FFIs that implement consolidated compliance programs.

#### **T.D. 9853, page 1026.**

These revisions to Treas. Reg. § 301.6707A-1 provide guidance on the calculation of the penalty under section 6707A, as amended by the Small Business Jobs Act of 2010. Section 6707A provides penalties for failure to include on any return

or statement any information required to be disclosed under section 6011 with respect to a reportable transaction. The final regulation addresses the meaning of the phrase “decrease in tax” for purposes of determining the amount of the penalty, the calculation of the penalty when a taxpayer fails to disclose participation in a transaction that becomes a reportable transaction after the taxpayer engaged in the transaction, the calculation of the penalty based on a failure to disclose liability for certain penalties in reports to the Securities and Exchange Commission pursuant to section 6707A(e), minimum and maximum penalty limits, and the calculation of the penalty where no tax is required to be shown on the return.

#### **REG-121694-16, page 1032.**

This document contains proposed regulations under section 301 of the Internal Revenue Code of 1986 (Code). The proposed regulations would update existing regulations under section 301 to reflect statutory changes made by the Technical and Miscellaneous Revenue Act of 1988, which changes provide that the amount of a distribution of property made by a corporation to its shareholder is the fair market value of the distributed property. The proposed regulations would affect any shareholder who receives a distribution of property from a corporation.

#### **REG-135671-17, page 1035.**

This notice of proposed rulemaking contains amendments to the Income Tax Regulations (26 CFR part 1) under section 337(d) of the Internal Revenue Code (Code) set forth in §1.337(d)-3 (final regulations) that prevent a corporate partner from using a partnership to avoid recognition of corporate-level gain. The rules set forth in this notice of proposed rulemaking contain substantive modifications to the final regulations relating to the definition of Stock of the Corporate Partner.

# The IRS Mission

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

## Introduction

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

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

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

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

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

### **Part II.—Treaties and Tax Legislation.**

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

### **Part III.—Administrative, Procedural, and Miscellaneous.**

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

### **Part IV.—Items of General Interest.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

# Part I.

## Section 61. Gross Income Defined

26 CFR 1.61-21: Taxation of fringe benefits.

### Rev. Rul. 2019-10

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61-21(g) of the

Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61-21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable

for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61-21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charge and SIFL mileage rates:

Period During Which the Flight Is Taken	Terminal Charge	SIFL Mileage Rates
1/1/19 - 6/30/19	\$43.53	Up to 500 miles = \$.2381 per mile  501-1500 miles = \$.1816 per mile  Over 1500 miles = \$.1745 per mile

### Drafting Information

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations and Employment Taxes). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 317-6798 (not a toll-free number).

26 CFR 1.1471-0; 26 CFR 1.1471-1; 26 CFR 1.1471-4; 26 CFR 1.1471-5; 26 CFR 1.1472-1

### T.D. 9852

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Chapter 4 Regulations Relating to Verification and Certification Requirements for Certain Entities and Reporting by Foreign Financial Institutions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

**SUMMARY:** This document finalizes (with limited revisions) certain proposed regulations. The final regulations provide compliance requirements and verification procedures for sponsoring entities of foreign financial institutions (FFIs) and certain non-financial foreign entities (NFFEs), trustees of certain trustee-documented trusts, registered deemed-compliant FFIs, and financial institutions that implement consolidated compliance programs (compliance FIs). These final regulations affect certain financial institutions and NFFEs.

**DATES:** *Effective date.* These regulations are effective on March 25, 2019.

*Applicability dates.* For dates of applicability, see §§1.1471-1(c), 1.1471-4(j), 1.1471-5(m), and 1.1472-1(h).

**FOR FURTHER INFORMATION CONTACT:** Charles Rioux, at (202) 317-6942 (not a toll free number).

### SUPPLEMENTARY INFORMATION:

#### Background

This Treasury decision contains amendments to 26 CFR part 1. On January 6, 2017, a notice of proposed rulemaking (REG-103477-14) proposing regulations

under chapter 4 of Subtitle A (sections 1471 through 1474) of the Internal Revenue Code of 1986 (Code) relating to verification requirements for certain entities was published in the **Federal Register** (82 FR 1629). The notice of proposed rulemaking also included proposed regulations, unrelated to these verification requirements, by cross-reference to temporary regulations that were published in the same issue of the **Federal Register** (82 FR 2124; TD 9809). On September 15, 2017, a correction to the notice of proposed rulemaking was published in the **Federal Register** (82 FR 43314). No public hearing was requested or held. Written comments were received, and are available at [www.regulations.gov](http://www.regulations.gov) or upon request. After consideration of the comments received, the proposed regulations relating to verification requirements for certain entities under chapter 4 are adopted (with limited modifications) by this Treasury decision. This Treasury decision does not finalize the proposed regulations in the notice of proposed rulemaking that cross-reference the temporary regulations. Those proposed regulations (REG-132857-17) will be adopted as final regulations at a later date. Hereinafter, the term “proposed regulations” when used in this preamble means the proposed regulations

(REG-103477-14) relating to verification requirements for certain entities under chapter 4.

The existing chapter 4 regulations permit certain FFIs and NFFEs to be sponsored by other entities (sponsoring entities) for purposes of satisfying their chapter 4 requirements. Generally, a sponsoring entity is an entity that agrees to perform chapter 4 due diligence, withholding, and reporting requirements on behalf of certain FFIs (sponsored FFIs) or chapter 4 due diligence and reporting obligations on behalf of certain direct reporting NFFEs (sponsored direct reporting NFFEs). An FFI that is a sponsored FFI is a deemed-compliant FFI, and a NFFE that is a sponsored direct reporting NFFE is an excepted NFFE. The proposed regulations provide verification requirements (including certifications of compliance) and events of default for sponsoring entities. The proposed regulations also provide certification requirements and procedures for the IRS's review of trustees of certain trustee-documented trusts and procedures for the IRS's review of periodic certifications provided by registered deemed-compliant FFIs. In addition, the proposed regulations describe the procedures for future modifications to the requirements for certifications of compliance for participating FFIs. The proposed regulations also clarify the requirements in the chapter 4 regulations for periodic certifications of compliance for consolidated compliance programs of participating FFIs and provide requirements for preexisting account certifications for these programs.

### **Summary of Comments and Explanation of Revisions**

After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The comments and revisions are discussed below.

#### *Definition of Responsible Officer*

The proposed regulations require a sponsoring entity of a sponsored FFI to appoint a responsible officer to oversee the compliance of the sponsoring entity with respect to each sponsored FFI. Proposed § 1.1471-1(b)(116) defines the

term *responsible officer* with respect to a sponsoring entity as an officer of the sponsoring entity with sufficient authority to fulfill the duties of a responsible officer described in § 1.1471-5(j) or § 1.1472-1(f) (as applicable). A comment requested that the definition of responsible officer be expanded to include an officer of an FFI in the sponsoring entity's expanded affiliated group that has responsibility for ensuring the compliance of the sponsoring entity. The comment noted that in some cases an investment manager that is a sponsoring entity is a member of an affiliated group in which one member of the group is designated to oversee the compliance of all members with their chapter 4 requirements.

The proposed regulations require the responsible officer of a sponsoring entity to be an individual who is an officer of the sponsoring entity because the certifications required under these regulations should be made by the individual in the best position to know and represent whether the sponsoring entity is complying with its obligations. The Department of the Treasury (Treasury Department) and the IRS understand that in practice, the person in the best position to know and represent if the sponsoring entity is complying with its obligations under these regulations may be an individual other than an officer of the sponsoring entity given industry practices established by managers and administrators of investment funds and similar vehicles for both chapter 4 and operational purposes. Therefore, these final regulations define responsible officer with respect to a sponsoring entity to include an officer of an entity that establishes and maintains policies and procedures for, and has general oversight over, the sponsoring entity, provided such individual has sufficient authority to fulfill the duties of a responsible officer described in § 1.1471-5(j) or § 1.1472-1(f) (as applicable).

A comment noted that many investment entities do not appoint officers but may appoint directors for corporate governance purposes who would be able to fulfill the requirements of responsible officers. The comment further noted that in many cases in which investment entities are partnerships, the general partner or managing member has authority to act on behalf of the partnership, and the general

partner or managing member may be an entity rather than an individual. The comment requested that the definition of a responsible officer of an investment entity be expanded to include these persons. In response to these comments, these final regulations revise the definition of a responsible officer of a financial institution or sponsoring entity that is an investment entity to include, in addition to an officer of such entity, an individual who is a director, managing member, or general partner of such entity, or, if the general partner or managing member of the investment entity is itself an entity, an individual who is an officer, director, managing member, or general partner of such other entity.

The comment also requested that the term responsible officer be expanded to include, with respect to a participating FFI, an officer of a U.S. financial institution (USFI) in the participating FFI's expanded affiliated group (in addition to an officer of a participating FFI or reporting Model 1 FFI in the participating FFI's expanded affiliated group). This comment is not adopted because § 1.1471-4(f) already permits a USFI to act as a compliance FI for purposes of establishing a consolidated compliance program and making a consolidated certification on behalf of one or more participating FFIs in an expanded affiliated group.

#### *Coordination of Certification Requirements for Compliance FIs and Sponsoring Entities of Sponsored FFIs or Sponsored Direct Reporting NFFEs*

A comment requested clarification that a certification of a compliance FI or sponsoring entity on behalf of an electing FFI, sponsored FFI, or sponsored direct reporting NFFE would satisfy the certification requirements of the electing FFI, sponsored FFI, or sponsored direct reporting NFFE. These final regulations clarify that to the extent a compliance FI or sponsoring entity satisfies the certification requirements in § 1.1471-4(f)(2)(ii), § 1.1471-5(j)(2) and (3), or § 1.1472-1(f)(2) on behalf of an electing FFI, sponsored FFI, or sponsored direct reporting NFFE, then the electing FFI, sponsored FFI, or sponsored direct reporting NFFE will not have a separate certification requirement under § 1.1471-4(f)(3), § 1.1471-5(f)(1)



(ii)(B), or §1.1472-1(c)(3)(vi). For example, if a participating FFI agrees to be a sponsored FFI, the FFI is not required to submit any certification with respect to its participating FFI status after it is registered as a sponsored FFI by its sponsoring entity provided its sponsoring entity certifies on behalf of the FFI to the extent required under §1.1471-5(j)(3).

The comment also requested that the certification period of a participating FFI that is a member of the expanded affiliated group that includes a compliance FI but is not an electing FFI under such compliance FI be aligned with the certification period of the compliance FI. The comment stated that coordinating the certification due dates of all FFIs in the expanded affiliated group would provide administrative benefits to the group. However, the comment did not explain why all FFIs could not join the consolidated compliance program. The Treasury Department and the IRS have decided not to revise the regulations in response to this request because a participating FFI already has the option of joining the consolidated compliance program under the compliance FI in order to align its certification period with that of the compliance FI.

#### *Requirement for a Written Sponsorship Agreement*

The proposed regulations require a responsible officer of a sponsoring entity to certify that the sponsoring entity is compliant with the requirements of a sponsoring entity and maintains effective internal controls with respect to all sponsored FFIs for which it acts (or provide a qualified certification). One of the statements to which the responsible officer must certify is that the sponsoring entity has a written sponsorship agreement in effect with each sponsored FFI authorizing the sponsoring entity to fulfill the requirements of §1.1471-5(f)(1)(i)(F) or (f)(2)(iii) or an applicable Model 2 IGA.

A comment requested the elimination of the requirement that the sponsoring entity have a written sponsorship agreement in effect with each sponsored FFI. The comment stated that this requirement would increase administrative burden for sponsored FFIs. Another comment requested clarification of whether the

sponsorship agreement must be a separate agreement between a sponsoring entity and a sponsored FFI that specifically refers to the requirements of a sponsoring entity with respect to a sponsored FFI under §1.1471-5(f)(1)(i)(F) or (f)(2)(iii) or an applicable Model 2 IGA. The comment stated that many sponsoring entities already have managerial agreements in place with sponsored FFIs that would allow the sponsoring entity to fulfill these requirements even without explicitly referring to them.

These final regulations retain the requirement that a sponsoring entity have a written sponsorship agreement in place with each sponsored FFI. A written sponsorship agreement memorializes the agreement between the parties, which helps to ensure compliance. However, in response to the comments and to reduce burden, the Treasury Department and the IRS have decided that it is not necessary for the sponsorship agreement to be a standalone agreement, and that a sponsorship agreement between a sponsoring entity and a sponsored FFI can refer generally to the obligations of the parties under FATCA. Accordingly, these final regulations provide that the written sponsorship agreement may be part of another agreement between the sponsoring entity and the sponsored FFI provided it refers to the requirements of a sponsored FFI under FATCA. For example, a provision in a fund manager agreement that states that the sponsoring entity agrees to satisfy the sponsored FFI's FATCA obligations would be sufficient. Additionally, the proposed regulations do not specify when a sponsorship agreement must be in place for purposes of a sponsoring entity's certification requirements. To allow sufficient time for a sponsoring entity to enter into sponsorship agreements (or revise existing agreements), these final regulations provide that a sponsoring entity of a sponsored FFI must have the written sponsorship agreement in place with such sponsored FFI by the later of March 31, 2019, or the date when the sponsoring entity begins acting as a sponsoring entity for such sponsored FFI. See §1.1471-5(j)(6). These final regulations include similar rules for a sponsoring entity of a sponsored direct reporting NFFE regarding the date by which the written sponsorship agreement must

be in place and that it need not be a standalone agreement. See §1.1472-1(f)(4).

#### *Extension of Time for Certifications for the Certification Period Ending on December 31, 2017, for Sponsoring Entities of Sponsored FFIs or Sponsored Direct Reporting NFFEs and Trustees of Trustee-Documented Trusts*

The proposed regulations provide that a sponsoring entity of a sponsored FFI or sponsored direct reporting NFFE and a trustee of a trustee-documented trust must make the certifications of compliance described in §1.1471-5(j)(3), §1.1471-5(l)(2), or §1.1472-1(f)(2), as applicable, on or before July 1 of the calendar year following the end of the certification period. The proposed regulations also provide that a sponsoring entity of a sponsored FFI must submit the preexisting account certification described in §1.1471-4(c)(7) by the due date of the sponsoring entity's certification of compliance for the certification period. The earliest certification period for a sponsoring entity or trustee of a trustee-documented trust ends on December 31, 2017, under the proposed regulations, making the earliest certification due date July 1, 2018. One comment requested that the certifications required of sponsoring entities be deferred to apply only for certification periods ending after 2018 in order to have sufficient time to prepare the certifications. The Treasury Department and the IRS understand that sponsoring entities need time to prepare for the certifications in light of the timing of the publication of these regulations. However, the Treasury Department and the IRS do not agree that sponsoring entities should not make certifications for the certification period ending December 31, 2017, because sponsoring entities have already had sufficient notice of their substantive requirements and because of the compliance value of certifications covering this period. These final regulations address the comment by providing additional time for sponsoring entities to make certifications that would otherwise be due on July 1, 2018. Under these final regulations, certifications by sponsoring entities and trustees of trustee-documented

trusts for the certification period ending on December 31, 2017, must be submitted on or before March 31, 2019.

*Registration by a Sponsored FFI or Sponsored Direct Reporting NFFE after Termination of the Sponsoring Entity by the IRS*

The proposed regulations provide that if a sponsoring entity of a sponsored FFI is terminated by the IRS, the sponsored FFI of the terminated sponsoring entity may not register as a sponsored FFI of a sponsoring entity that has a relationship described in section 267(b) with the terminated sponsoring entity unless the sponsored FFI obtains written approval from the IRS. The proposed regulations provide a similar rule regarding a terminated sponsoring entity of a sponsored direct reporting NFFE, but do not permit the sponsored direct reporting NFFE to obtain written approval from the IRS to register as a sponsored direct reporting NFFE of a section 267(b)-related sponsoring entity.

Section 267(b) describes certain relationships among individuals, corporations, trusts, tax-exempt organizations, and S corporations. The rules described in this paragraph are intended to prevent a sponsored FFI or sponsored direct reporting NFFE from registering under an entity that is related to the terminated sponsoring entity, such as an entity under common control with the terminated sponsoring entity. However, the proposed regulations inadvertently omitted certain relationships between sponsoring entities that are partnerships. These final regulations correct this omission by providing that the rules described in this paragraph generally prohibit registration by a sponsored FFI or sponsored direct reporting NFFE under a sponsoring entity that has a relationship described in section 267(b) or 707(b) to

the terminated sponsoring entity. Thus, for example, a sponsored FFI of a terminated sponsoring entity that is a partnership may not register under another sponsoring entity that is a partnership if the same person owns, directly or indirectly, more than 50 percent of capital interests or profits interests of both sponsoring entities. Additionally, these final regulations conform the rule for sponsored direct reporting NFFEs with the rule for sponsored FFIs by allowing a sponsored direct reporting NFFE to register under a sponsoring entity, notwithstanding that there is the impermissible relationship described in this paragraph, if the sponsored direct reporting NFFE obtains written approval from the IRS.

*Sponsored Entities Located in a Model 1 IGA Jurisdiction*

The preamble to the proposed regulations provides that a financial institution covered by a Model 1 IGA that chooses to qualify as a sponsored FFI under §1.1471-5(f) instead of Annex II of the Model 1 IGA must satisfy all of the requirements of the regulations applicable to such an entity. 82 FR 1629 at 1631. Comments requested that a financial institution located in a jurisdiction with a Model 1 IGA that does not include a sponsored entity as a type of non-reporting financial institution in Annex II be allowed to comply with local guidance on sponsored entities or the Model 1 IGA Annex II rather than the regulations. The Treasury Department and the IRS are open to discussing the issue with the competent authorities of affected jurisdictions.

*Nonsubstantive Changes*

These final regulations include several minor nonsubstantive changes to the

proposed regulations. Section 1.1471-4(f)(2)(ii)(B)(I) was reorganized for clarity. Minor clarifying edits were made in §§1.1471-4(f)(3)(i), 1.1471-5(f)(1)(i)(F)(4), (f)(1)(iv) introductory text, (f)(1)(iv)(A) and (B), (f)(2)(iii)(E), (j)(3)(ii) and (iii), (j)(4)(ii), (j)(5) and (6), (k)(4)(i), (ii), (iii), and (v), and (l)(2)(ii) and (iii), and 1.1472-1(f)(2)(ii) and (iii), (f)(3)(ii), (f)(4)(vii), and (g)(4)(i), (ii), and (iii).

**Special Analyses**

The Administrator of the Office of Information and Regulatory Affairs (OIRA), Office of Management and Budget, has waived review of this rule in accordance with section 6(a)(3)(A) of Executive Order 12866. This rule is an EO 13771 regulatory action.

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2246. The collection of information in these final regulations is in §§1.1471-4, 1.1471-5 and 1.1472-1. The collection of information is on a certification filed with the IRS regarding the filer's compliance with its chapter 4 requirements. This information is required to enable the IRS to verify that a taxpayer is complying with its requirements under chapter 4. Certifications are required from compliance FIs, sponsoring entities, and trustees of trustee-documented trusts. Information on the estimated number of compliance FIs, sponsoring entities, and trustees of trustee-documented trusts required to submit a certification under these final regulations is shown in table 1.

TABLE 1	
	<i>Number of respondents (estimated)</i>
Compliance FIs	5,000 – 10,000
Sponsoring entities and trustees of trustee-documented trusts	10,000 – 15,000

Information on the number of compliance FIs, sponsoring entities, and trustees of trustee-documented trusts shown in ta-

ble 1 is from the IRS's FATCA registration data. Comments are requested on the estimated number of respondents.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the

collection of information displays a valid control number.

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

It is hereby certified that the collection of information requirement in these final regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Although the Treasury Department and IRS acknowledge that a small entity could be a compliance FI that is affected by these regulations, the Treasury Department and IRS have concluded this possibility is too small and the potential effect is too minimal to have a significant impact. Additionally, acting as a compliance FI is not required under the chapter 4 regulations. Furthermore, these regulations do not increase the regulatory burden on small entities because they clarify existing chapter 4 regulations regarding a compliance FI's certification obligations. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations 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 Charles Rioux, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

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#### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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. Section 1.1471-0 is amended by:

1. Adding entries for §1.1471-4(f)(2)(ii)(B)(I), (f)(2)(ii)(B)(1)(i) and (ii), (f)(2)(ii)(B)(2), and (j)(1) and (2).

2. Adding entries for §1.1471-5(f)(1)(iv), (f)(1)(iv)(A) and (B), (j)(1), (2), and (3), (j)(3)(i), (j)(3)(i)(A) and (B), (j)(3)(ii) through (vi), (j)(3)(vi)(A) and (B), (j)(3)(vii), (j)(4), (j)(4)(i) through (iii), (j)(5) and (6), (k)(1) through (4), (k)(4)(i) through (v).

4. Revising the entry for §1.1471-5(l).

5. Adding entries for §1.1471-5(l)(1) and (2), (l)(2)(i), (l)(2)(i)(A) and (B), (l)(2)(ii) through (iv), (l)(3), (l)(3)(i) and (ii), and (m).

6. Adding entries for §1.1472-1(f)(1) and (2), (f)(2)(i), (f)(2)(i)(A) and (B), (f)(2)(ii) through (iv), (f)(3), (f)(3)(i) and (ii), (f)(4), (g)(1) through (g)(4), and (g)(4)(i) through (iv).

The additions and revisions read as follows:

*§1.1471-0 Outline of regulation provisions for sections 1471 through 1474.*

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*§1.1471-4 FFI agreement.*

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(f) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) \* \* \*

(I) Periodic certification.

(i) In general.

(ii) Late-joining electing FFIs.

(2) Preexisting account certification.

\*\*\*\*\*

(j) \* \* \*

(1) In general.

(2) Special applicability date.

*§1.1471-5 Definitions applicable to section 1471.*

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(f) \* \* \*

(1) \* \* \*

(iv) IRS review of compliance by registered deemed-compliant FFIs.

(A) General inquiries.

(B) Inquiries regarding substantial non-compliance.

\*\*\*\*\*

(j) \* \* \*

(1) In general.

(2) Compliance program.

(3) Certification of compliance.

(i) Certification requirement.

(A) In general.

(B) Extension of time for the certification period ending on December 31, 2017.

(ii) Late-joining sponsored FFIs.

(iii) Certification period.

(iv) Additional certifications or information.

(v) Certifications regarding sponsoring entity and sponsored FFI requirements.

(vi) Certifications regarding internal controls.

(A) Certification of effective internal controls.

(B) Qualified certification.

(vii) Material failures defined.

(4) IRS review of compliance.

(i) General inquiries.

(ii) Inquiries regarding substantial non-compliance.

(iii) Compliance procedures for a sponsored FFI subject to a Model 2 IGA.

(5) Preexisting account certification.

(6) Sponsorship agreement.

(k) \* \* \*

(1) Defined.

(2) Notice of event of default.

(3) Remediation of event of default.

(4) Termination.

(i) In general.

(ii) Termination of sponsoring entity.

(iii) Termination of sponsored FFI.

(iv) Reconsideration of notice of default or notice of termination.

(v) Sponsoring entity of sponsored FFIs subject to a Model 2 IGA.

(l) Trustee-documented trust verification.

(1) Compliance program.

(2) Certification of compliance.

(i) Certification requirement.

(A) In general.

(B) Extension of time for the certification period ending on December 31, 2017.

(ii) Late-joining trustee-documented trusts.

(iii) Certification period.

(iv) Certifications.

(3) IRS review of compliance by trustees of trustee-documented trusts.

(i) General inquiries.

(ii) Inquiries regarding substantial non-compliance.

(m) Applicability date.

\* \* \* \* \*

*§1.1472-1 Withholding on NFFE's.*

\* \* \* \* \*

(f) \* \* \*

(1) In general.

(2) Certification of compliance.

(i) Certification requirement.

(A) In general.

(B) Extension of time for the certification period ending on December 31, 2017.

(ii) Late-joining sponsored direct reporting NFFE's.

(iii) Certification period.

(iv) Certifications.

(3) IRS review of compliance.

(i) General inquiries.

(ii) Inquiries regarding substantial non-compliance.

(4) Sponsorship agreement.

(g) \* \* \*

(1) Defined.

(2) Notice of event of default.

(3) Remediation of event of default.

(4) Termination.

(i) In general.

(ii) Termination of sponsoring entity.

(iii) Termination of sponsored direct reporting NFFE.

(iv) Reconsideration of notice of default or notice of termination.

\* \* \* \* \*

Par. 3. Section 1.1471-1 is amended by revising paragraphs (b)(116) and (121) and (c) to read as follows:

*§1.1471-1 Scope of chapter 4 and definitions.*

\* \* \* \* \*

(b) \* \* \*

(116) *Responsible officer.* The term *responsible officer* means, with respect to a participating FFI, an officer of any participating FFI or reporting Model 1 FFI in the participating FFI's expanded affiliated group with sufficient authority to fulfill the duties of a responsible officer described in §1.1471-4, which include the requirement to periodically certify to the IRS regarding the FFI's compliance with its FFI agreement. The term *responsible officer* means, in the case of a registered deemed-compliant FFI, an officer of any deemed-compliant FFI or participating

FFI in the deemed-compliant FFI's expanded affiliated group with sufficient authority to ensure that the FFI meets the applicable requirements of §1.1471-5(f). The term *responsible officer* means, with respect to a sponsoring entity, an officer of the sponsoring entity or an officer of an entity that establishes and maintains policies and procedures for, and has general oversight over, the sponsoring entity, provided such officer has sufficient authority to fulfill the duties of a responsible officer described in §1.1471-5(j) or §1.1472-1(f) (as applicable). If a participating FFI elects to be part of a consolidated compliance program, the term *responsible officer* means an officer of the compliance FI (as described in §1.1471-4(f)) with sufficient authority to fulfill the duties of a responsible officer described in §1.1471-4(f) (2) and (3) on behalf of each FFI in the compliance group. In the case of an FI or sponsoring entity that is an investment entity, for purposes of this paragraph (b) (116), the responsible officer may be, in lieu of an officer of the investment entity, an individual who is a director, managing member, or general partner of the investment entity or, if the general partner or managing member of the investment entity is itself an entity, an individual who is an officer, director, managing member, or general partner of such other entity.

\* \* \* \* \*

(121) *Sponsored FFI.* The term *sponsored FFI* means any entity described in §1.1471-5(f)(1)(i)(F) (describing sponsored investment entities and sponsored controlled foreign corporations) or §1.1471-5(f)(2)(iii) (describing sponsored, closely held investment vehicles). The term *sponsored FFI* also means a sponsored investment entity, a sponsored controlled foreign corporation, or a sponsored, closely held investment vehicle treated as deemed-compliant under an applicable Model 2 IGA.

\* \* \* \* \*

(c) *Applicability date.* This section generally applies beginning on January 6, 2017, except for paragraphs (b)(116) and (121) of this section, which apply beginning on March 25, 2019. However, taxpayers may apply these provisions as of January 28, 2013. (For the rules that otherwise apply beginning on January 6, 2017, and before March 25, 2019, see this sec-

tion as in effect and contained in 26 CFR part 1 revised April 1, 2018. For rules that otherwise apply beginning on January 28, 2013, and before January 6, 2017, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2016.)

Par. 4. Section 1.1471-4 is amended by:

1. Revising paragraphs (f)(2)(ii)(A).

2. Adding paragraphs (f)(2)(ii)(B)(I) and (2).

3. Revising paragraphs (f)(3)(i), (g)(2), and (j)(1).

The revisions and additions read as follows:

*§1.1471-4 FFI agreement.*

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(ii) \* \* \* (A) *In general.* A participating FFI that is a member of an expanded affiliated group that includes one or more FFIs may elect to be part of a consolidated compliance program (and perform a consolidated periodic review) under the authority of a participating FFI, reporting Model 1 FFI, or U.S. financial institution (compliance FI) that is a member of the electing FFI's expanded affiliated group, regardless of whether all such members so elect. In addition, when an FFI elects to be part of a consolidated compliance program, each branch that it maintains (including a limited branch or a branch described in §1.1471-5(f)(1)), other than a branch located in a Model 1 IGA jurisdiction, must be subject to periodic review as part of such program and included on the periodic certification (described in paragraph (f) (2)(ii)(B)(I) of this section). To the extent that a compliance FI satisfies the certification requirements of paragraph (f)(2)(ii) (B) of this section on behalf of an electing FFI, such electing FFI does not have a certification requirement under paragraph (f)(3) of this section. See §1.1471-5(j) for the requirement of a sponsoring entity to establish and implement a compliance program for its sponsored FFIs.

(B) \* \* \*

(I) *Periodic certification*—(i) *In general.* On or before July 1 of the calendar year following the end of the certification period, the responsible officer of the compliance FI must make the certification described in either paragraph (f)(3)(ii) or (iii)



of this section with respect to all electing FFI's for which it acts during the certification period on the form and in the manner prescribed by the IRS. The certification must be made on behalf of all electing FFI's in the compliance group during the certification period, except as otherwise provided in paragraph (f)(2)(ii)(B)(1)(ii) of this section. The first certification period for a compliance group begins on the later of the date the compliance FI is issued a GIIN or June 30, 2014, and ends at the close of the third full calendar year following such date. Each subsequent certification period is the three-calendar-year period following the previous certification period.

(ii) *Late-joining electing FFI's.* In general, with respect to a certification period, a compliance FI is not required to make a certification for an electing FFI that first elects to be part of the consolidated compliance program of the compliance FI during the six-month period before the end of the certification period, provided that the compliance FI makes certifications for such electing FFI for subsequent certification periods, and the first such certification covers both the subsequent certification period and the portion of the prior certification period of the compliance group during which such FFI was an electing FFI in the consolidated compliance program of the compliance FI. However, the preceding sentence does not apply to an electing FFI that, immediately before the electing FFI elects to be part of the consolidated compliance program, was a participating FFI or registered deemed-compliant FFI. The compliance FI may certify for an electing FFI described in the preceding sentence for the portion of the certification period of the compliance group before the date that the electing FFI elects to be part of the consolidated compliance program if the compliance FI obtains from the FFI (or the FFI's former compliance FI, if applicable) a written certification that the FFI has complied with its applicable chapter 4 requirements during such portion of the certification period, provided that: the compliance FI does not know that such certification is unreliable or incorrect; and the certification for the electing FFI for the subsequent certification period covers both the subsequent certification

period and the portion of the prior certification period during which such FFI was an electing FFI in the consolidated compliance program of the compliance FI.

(2) *Preexisting account certification.* The responsible officer of a compliance FI must make the certification described in paragraph (c)(7) of this section (preexisting account certification of a participating FFI) with respect to each electing FFI that elects to be part of the consolidated compliance program under the compliance FI during the certification period. However, a preexisting account certification is not required for an electing FFI if immediately before electing to be part of the consolidated compliance program under the compliance FI the FFI was a participating FFI or a registered deemed-compliant FFI that is a local FFI or restricted fund, and the FFI (or the FFI's former compliance FI, if applicable) provides a written certification to the compliance FI that the FFI has made the preexisting account certification required under paragraph (c)(7) of this section or §1.1471-5(f)(1)(i)(A)(7) or (f)(1)(i)(D)(6) (as applicable), unless the compliance FI knows that such written certification is unreliable or incorrect. In addition, a preexisting account certification is not required for an electing FFI that elects to be part of the consolidated compliance program under the compliance FI during the two year period before the end of the certification period, provided that the compliance FI makes the preexisting account certification for such FFI for the subsequent certification period. The certification required under this paragraph (f)(2)(ii)(B)(2) for the certification period must be submitted by the due date of the FFI's certification of compliance required under paragraph (f)(2)(ii)(B)(1)(i) of this section for the certification period, on the form and in the manner prescribed by the IRS.

(3) \* \* \*

(i) *In general.* In addition to the certifications required under paragraph (c)(7) of this section, on or before July 1 of the calendar year following the end of each certification period, the responsible officer must make the certification described in either paragraph (f)(3)(ii) or (iii) of this section on the form and in the manner prescribed by the IRS. The first certification period begins on the effective date of

the FFI agreement and ends at the close of the third full calendar year following the effective date of the FFI agreement. Each subsequent certification period is the three-calendar-year period following the previous certification period, unless the FFI agreement provides for a different period. The responsible officer must either certify that the participating FFI maintains effective internal controls or, if the participating FFI has identified an event of default (defined in paragraph (g) of this section) or a material failure (defined in paragraph (f)(3)(iv) of this section) that it has not corrected as of the date of the certification, must make the qualified certification described in paragraph (f)(3)(iii) of this section. The certification of compliance described in paragraph (f)(3)(ii) or (iii) of this section may be modified through an amendment to the FFI agreement to include any additional certifications or information (such as quantitative or factual information related to the FFI's compliance with the FFI agreement), provided that any additional information or certifications are published at least 90 days before being incorporated into the FFI agreement to allow for public comment.

\* \* \* \* \*

(g) \* \* \*

(2) *Notice of event of default.* Following an event of default known by or disclosed to the IRS, the IRS will deliver to the participating FFI a notice of default specifying the event of default. The IRS will request that the participating FFI remediate the event of default within 45 days (unless additional time is requested and agreed to by the IRS). The participating FFI must respond to the notice of default and provide information responsive to an IRS request for information or state the reasons why the participating FFI does not agree that an event of default has occurred. Taking into account the terms of any applicable Model 2 IGA, if the participating FFI does not provide a response within the specified time period, the IRS may, at its sole discretion, deliver a notice of termination that terminates the FFI's participating FFI status. If the FFI's participating FFI status is terminated, in addition to the requirements in §1.1471-3(c)(6)(ii)(E)(2), the FFI must, within 30 days of the termi-

nation, send notice of the termination to each withholding agent from which it receives payments and each financial institution with which it holds an account for which a withholding certificate or other documentation was provided. An FFI that has had its participating FFI status terminated may not reregister on the FATCA registration website as a participating FFI or registered deemed-compliant FFI unless it receives written approval from the IRS to register. A participating FFI may request, within 90 days of a notice of default or notice of termination, reconsideration of a notice of default or notice of termination by written request to the IRS.

\*\*\*\*\*

(j) \* \* \* (1) *In general.* This section generally applies beginning on January 6, 2017, except for paragraphs (f)(2)(ii)(A), (f)(2)(ii)(B)(I) and (2), (f)(3)(i), and (g)(2) of this section, which apply March 25, 2019. However, taxpayers may apply these provisions as of January 28, 2013. (For the rules that otherwise apply beginning on January 6, 2017, and before March 25, 2019, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2018. For rules that apply beginning on January 23, 2013 and before January 6, 2017, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2016.)

\*\*\*\*\*

Par. 5. Section 1.1471-5 is amended by:

1. Revising paragraph (f)(1)(i)(F)(3) (vi).
2. Removing paragraph (f)(1)(i)(F)(3) (vii).
3. Redesignating paragraph (f)(1)(i)(F)(3)(viii) as paragraph (f)(1)(i)(F)(3)(vii).
4. Revising paragraph (f)(1)(i)(F)(4).
5. Adding paragraph (f)(1)(iv).
6. Revising paragraph (f)(2)(iii)(D)(4).
7. Removing paragraph (f)(2)(iii)(D)(5).
8. Redesignating paragraph (f)(2)(iii)(D)(6) as paragraph (f)(2)(iii)(D)(5).
9. Revising paragraph (f)(2)(iii)(E).
10. Revising paragraphs (j) and (k).
11. Redesignating paragraph (l) as paragraph (m).
12. Adding new paragraph (l).
13. Revising newly redesignated paragraph (m).

The revisions and additions read as follows:

*§1.1471-5 Definitions applicable to section 1471.*

\*\*\*\*\*

(f) \* \* \*

(1) \* \* \*

(i) \* \* \*

(F) \* \* \*

(3) \* \* \*

(vi) Complies with the verification procedures described in paragraph (j) of this section; and

\*\*\*\*\*

(4) The IRS may revoke a sponsoring entity's status with respect to one or more sponsored FFIs based on the provisions of paragraphs (k)(2), (3), and (4) of this section (describing notice of event of default, remediation, and termination procedures) if there is an event of default as defined in paragraph (k)(1) of this section.

\*\*\*\*\*

(iv) *IRS review of compliance by registered deemed-compliant FFIs--(A) General inquiries.* With respect to a registered deemed-compliant FFI described in paragraph (f)(1)(i)(A), (C), or (D) of this section, the IRS, based upon the information reporting forms described in §1.1471-4(d)(3)(v), (d)(5)(vii), or (d)(6)(iv) filed with the IRS for each calendar year (if applicable), may request additional information with respect to the information reported (or required to be reported) on the forms, the account statements described in §1.1471-4(d)(4)(v), or confirmation that the FFI has no reporting requirements for the calendar year. The IRS may request additional information from the FFI to determine the FFI's compliance with §1.1471-4 (if applicable) and to assist the IRS with its review of account holder compliance with tax reporting requirements. For IRS review of compliance with respect to a registered deemed-compliant FFI described in paragraph (f)(1)(i)(F) of this section (describing sponsored investment entities and controlled foreign corporations), see paragraph (j)(4) of this section.

(B) *Inquiries regarding substantial non-compliance.* With respect to a registered deemed-compliant FFI described in paragraph (f)(1)(i)(A) through (E) of this section, the IRS may determine in its discretion that the FFI may not have substantially complied with the requirements of the deemed-compliant status claimed by

the FFI. This determination is based on the information reporting forms described in §1.1471-4(d)(3)(v), (d)(5)(vii), or (d)(6)(iv) filed with the IRS for each calendar year (if applicable), the certifications made by the responsible officer described in paragraph (f)(1)(ii)(B) of this section (or the absence of such certifications), or any other information related to the FFI's compliance with the requirements of the deemed-compliant status claimed by the FFI. In such a case, the IRS may request from the responsible officer (or designee) information necessary to verify the FFI's compliance with the requirements for the deemed-compliant status claimed by the FFI. For example, in the case of a local FFI under paragraph (f)(1)(i)(A) of this section, the IRS may request a description or copy of the FFI's policies and procedures for identifying accounts held by specified U.S. persons not resident in the jurisdiction in which the FFI is incorporated or organized, identifying entities controlled or beneficially owned by such persons, and identifying nonparticipating FFIs. The IRS may also request the performance of specified review procedures by a person (including an external auditor or third-party consultant) that the IRS identifies as competent to perform such procedures given the facts and circumstances surrounding the FFI's potential failure to comply with the requirements of the deemed-compliant category claimed by the FFI. If the IRS determines that the FFI has not complied with the requirements of the deemed-compliant status claimed by the FFI, the IRS may terminate the FFI's deemed-compliant status. If the FFI's deemed-compliant status is terminated, the FFI must send notice of the termination to each withholding agent from which it receives payments and each financial institution with which it holds an account for which a withholding certificate or other documentation was provided within 30 days after the termination. An FFI that has had its deemed-compliant status terminated may not reregister on the FATCA registration website as a registered deemed-compliant FFI or register on the FATCA registration website as a participating FFI unless it receives written approval from the IRS. A registered deemed-compliant FFI may request, within 90 days of a notice of termination, re-

consideration of the notice of termination by written request to the IRS.

(2) \* \* \*

(iii) \* \* \*

(D) \* \* \*

(4) Complies with the verification procedures described in paragraph (j) of this section; and

\* \* \* \* \*

(E) The IRS may revoke a sponsoring entity's status as a sponsoring entity with respect to one or more sponsored FFIs based on the provisions of paragraphs (k) (2), (3), and (4) of this section (describing notice of event of default, remediation, and termination procedures) if there is an event of default as defined in paragraph (k)(1) of this section. A sponsoring entity is not liable for any failure to comply with the obligations contained in paragraph (f) (2)(iii)(D) of this section unless the sponsoring entity is a withholding agent that is separately liable for the failure to withhold on or report with respect to a payment made by the sponsoring entity on behalf of the sponsored FFI. A sponsored FFI will remain liable for any failure of its sponsoring entity to comply with the obligations contained in paragraph (f)(2)(iii)(D) of this section that the sponsoring entity has agreed to undertake on behalf of the FFI, even if the sponsoring entity is also a withholding agent and is itself separately liable for the failure to withhold on or report with respect to a payment made by the sponsoring entity on behalf of the sponsored FFI. The same tax, interest, or penalties, however, shall not be collected more than once.

\* \* \* \* \*

(j) *Sponsoring entity verification--*(1) *In general.* This paragraph (j) describes the requirements for a sponsoring entity of a sponsored FFI to establish and implement a compliance program for satisfying its requirements as a sponsoring entity and to provide a certification of compliance with its requirements. This paragraph (j) also describes the procedures for the IRS to review the sponsoring entity's compliance with respect to each sponsored FFI for purposes of satisfying the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA. For purposes of a sponsoring entity's certification of compliance under this paragraph (j), a sponsoring entity

must have in place a written sponsorship agreement described in paragraph (j)(6) of this section with each sponsored FFI. See paragraph (j)(3)(v)(B) of this section for the certification regarding a sponsoring entity's sponsorship agreement with each sponsored FFI.

(2) *Compliance program.* The sponsoring entity must appoint a responsible officer to oversee the compliance of the sponsoring entity with respect to each sponsored FFI for purposes of satisfying the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA. The responsible officer must (either personally or through designated persons) establish a compliance program that includes policies, procedures, and processes sufficient for the sponsoring entity to satisfy the requirements described in the preceding sentence. The responsible officer (or designee) must periodically review the sufficiency of the sponsoring entity's compliance program, the sponsoring entity's compliance with respect to each sponsored FFI for purposes of satisfying the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA, and the compliance of each sponsored FFI with the due diligence, withholding, and reporting requirements of §1.1471-4 or an applicable Model 2 IGA during the certification period described in paragraph (j) (3)(iii) of this section. The results of the periodic review must be considered by the responsible officer in making the periodic certifications described in paragraph (j)(3) of this section.

(3) *Certification of compliance--*(i) *Certification requirement--*(A) *In general.* In addition to the certification required under paragraph (j)(5) of this section (pre-existing account certification), and except as otherwise provided in paragraph (j)(3)(i)(B) or (j)(3)(ii) of this section, on or before July 1 of the calendar year following the certification period, the responsible officer of the sponsoring entity must make the certification described in paragraph (j) (3)(v) of this section and either the certification described in paragraph (j)(3)(vi)(A) of this section or the certification described in paragraph (j)(3)(vi)(B) of this section with respect to all sponsored FFIs for which the sponsoring entity acts during the certification period on the form and in

the manner prescribed by the IRS. To the extent that a sponsoring entity satisfies the certification requirements of paragraph (j) (3) of this section on behalf of a sponsored FFI, the sponsored FFI does not have a certification requirement under paragraph (f)(1)(ii)(B) of this section.

(B) *Extension of time for the certification period ending on December 31, 2017.* The certifications required for a certification period ending on December 31, 2017, must be submitted on or before March 31, 2019.

(ii) *Late-joining sponsored FFIs.* In general, with respect to a certification period, a sponsoring entity is not required to make a certification for a sponsored FFI that first agrees to be sponsored by the sponsoring entity during the six-month period before the end of the sponsoring entity's certification period, provided that the sponsoring entity makes certifications for such sponsored FFI for subsequent certification periods and the first such certification covers both the subsequent certification period and the portion of the prior certification period of the sponsoring entity during which such FFI was sponsored by the sponsoring entity. However, the preceding sentence does not apply to a sponsored FFI that, immediately before the FFI agrees to be sponsored by the sponsoring entity, was a participating FFI, registered deemed-compliant FFI, or sponsored, closely held investment vehicle of another sponsoring entity. The sponsoring entity may certify for a sponsored FFI described in the preceding sentence for the portion of the certification period of the sponsoring entity before the date that the FFI first agrees to be sponsored by the sponsoring entity if the sponsoring entity obtains from the FFI (or the FFI's sponsoring entity, if applicable) a written certification that the FFI has complied with its applicable chapter 4 requirements during such portion of the certification period, provided that: the sponsoring entity does not know that such certification is unreliable or incorrect; and the certification for the sponsored FFI for the subsequent certification period covers both the subsequent certification period and the portion of the prior certification period during which such FFI was sponsored by the sponsoring entity.

(iii) *Certification period.* The first certification period of a sponsoring entity be-



gins on the later of the date the sponsoring entity is issued a GIIN to act as a sponsoring entity or June 30, 2014, and ends at the close of the third full calendar year following such date. Each subsequent certification period is the three-calendar-year period following the previous certification period.

(iv) *Additional certifications or information.* The certification of compliance described in paragraph (j)(3) of this section may be modified to include additional certifications or information (such as quantitative or factual information related to the sponsoring entity's compliance with respect to each sponsored FFI for purposes of satisfying the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA), provided that such additional information or certifications are published at least 90 days before being made effective in order to allow for public comment.

(v) *Certifications regarding sponsoring entity and sponsored FFI requirements.* The responsible officer of the sponsoring entity must certify to the following statements--

(A) The sponsoring entity meets all of the requirements of a sponsoring entity as described in paragraph (f)(1)(i)(F)(3) or (f)(2)(iii)(D) of this section or an applicable Model 2 IGA, including the chapter 4 status required of such entity;

(B) The sponsoring entity has a written sponsorship agreement in effect with each sponsored FFI authorizing the sponsoring entity to fulfill the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA with respect to each sponsored FFI; and

(C) Each sponsored FFI treated as a sponsored investment entity, a sponsored controlled foreign corporation, or a sponsored, closely held investment vehicle by the sponsoring entity meets the requirements of its respective status.

(vi) *Certifications regarding internal controls--*(A) *Certification of effective internal controls.* The responsible officer of the sponsoring entity must certify to the following statements--

(1) The responsible officer of the sponsoring entity has established a compliance program that is in effect as of the date of the certification and that has been subject

to the review as described in paragraph (j)(2) of this section;

(2) With respect to material failures (defined in paragraph (j)(3)(vii) of this section)--

(i) There are no material failures for the certification period; or

(ii) If there were any material failures, appropriate actions were taken to remediate such failures and to prevent such failures from reoccurring; and

(3) With respect to any failure to withhold, deposit, or report to the extent required under §1.1471-4 or an applicable Model 2 IGA with respect to any sponsored FFI for any year during the certification period, the sponsored FFI has corrected such failure by paying (or directing the sponsoring entity to pay) any taxes due (including interest and penalties) and filing (or directing the sponsoring entity to file) the appropriate return (or amended return).

(B) *Qualified certification.* If the responsible officer of the sponsoring entity has identified an event of default (defined in paragraph (k)(1) of this section) or a material failure (defined in paragraph (j)(3)(vii) of this section) that the sponsoring entity has not corrected as of the date of the certification, the responsible officer must certify to the following statements--

(1) The responsible officer of the sponsoring entity has established a compliance program that is in effect as of the date of the certification and that has been subjected to the review as described in paragraph (j)(2) of this section;

(2) With respect to the event of default or material failure--

(i) The responsible officer (or designee) has identified an event of default; or

(ii) The responsible officer has determined that there are one or more material failures as defined in paragraph (j)(3)(vii) of this section and that appropriate actions will be taken to prevent such failures from reoccurring;

(3) With respect to any failure to withhold, deposit, or report to the extent required under §1.1471-4 or an applicable Model 2 IGA with respect to any sponsored FFI for any year during the certification period, the sponsored FFI will correct such failure by paying (or directing the sponsoring entity to pay) any taxes

due (including interest and penalties) and filing (or directing the sponsoring entity to file) the appropriate return (or amended return); and

(4) The responsible officer (or designee) will respond to any notice of default under paragraph (k)(2) of this section or will provide to the IRS a description of each material failure and a written plan to correct each such failure when requested under paragraph (j)(4) of this section.

(vii) *Material failures defined.* A material failure is a failure of the sponsoring entity with respect to each sponsored FFI to satisfy the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA if the failure was the result of a deliberate action on the part of one or more employees of the sponsoring entity or was an error attributable to a failure of the sponsoring entity to implement internal controls sufficient for the sponsoring entity to meet its requirements. A material failure will not constitute an event of default unless such material failure occurs in more than limited circumstances when a sponsoring entity has not substantially complied with the requirements described in the preceding sentence. Material failures include the following--

(A) With respect to any sponsored FFI, the deliberate or systematic failure of the sponsoring entity to report accounts that such sponsored FFI was required to treat as U.S. accounts, withhold on passthru payments to the extent required, deposit taxes withheld to the extent required, accurately report recalcitrant account holders (or non-consenting U.S. accounts under an applicable Model 2 IGA), or accurately report with respect to nonparticipating FFIs as required under §1.1471-4(d)(2)(ii)(F) or an applicable Model 2 IGA;

(B) A criminal or civil penalty or sanction imposed on the sponsoring entity or any sponsored FFI (or any branch or office of the sponsoring entity or any sponsored FFI) by a regulator or other governmental authority or agency with oversight over the sponsoring entity's or sponsored FFI's compliance with the AML due diligence procedures to which it (or any branch or office thereof) is subject and that is imposed based on a failure to properly identify account holders under the requirements of those procedures;



(C) A potential future tax liability of any sponsored FFI related to its compliance (or lack thereof) with the due diligence, withholding, and reporting requirements of §1.1471-4 or an applicable Model 2 IGA for which such sponsored FFI has established, for financial statement purposes, a tax reserve or provision;

(D) A potential contractual liability under the agreement described in paragraph (j)(3)(v)(B) of this section of the sponsoring entity to any sponsored FFI related to such sponsoring entity's compliance (or lack thereof) with paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA for which the sponsoring entity has established, for financial statement purposes, a reserve or provision; and

(E) Failure to register with the IRS as a sponsoring entity or to register each sponsored FFI required to be registered under paragraph (f)(1)(i)(F)(3)(iii) of this section or an applicable Model 2 IGA.

(4) *IRS review of compliance--(i) General inquiries.* The IRS, based upon the information reporting forms described in §1.1471-4(d)(3)(v), (d)(5)(vii), or (d)(6)(iv) filed with the IRS (or the absence of such reporting) by the sponsoring entity for each calendar year with respect to any sponsoring FFI, may request additional information with respect to the information reported (or required to be reported) on the forms, the account statements described in §1.1471-4(d)(4)(v) with respect to one or more sponsored FFIs, or confirmation that the FFI has no reporting requirements. The IRS may also request any additional information from the sponsoring entity (including a copy of each sponsorship agreement the sponsoring entity has entered into with each sponsored FFI) necessary to determine the compliance with the due diligence, withholding, and reporting requirements of §1.1471-4 or an applicable Model 2 IGA with respect to each sponsored FFI and to assist the IRS with its review of account holder compliance with tax reporting requirements.

(ii) *Inquiries regarding substantial non-compliance.* The IRS may determine in its discretion that a sponsoring entity may not have substantially complied with the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA with respect to any sponsored FFI. This determination is based on

the information reporting forms described in §1.1471-4(d)(3)(v), (d)(5)(vii), or (d)(6)(iv) filed with the IRS by the sponsoring entity for each calendar year with respect to any sponsored FFI (or the absence of reporting), the certifications made by the responsible officer described in paragraphs (j)(3) and (5) of this section (or the absence of such certifications), or any other information related to the sponsoring entity's compliance with respect to any sponsored FFI for purposes of satisfying the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA. In such a case, the IRS may request from the responsible officer (or designee) information necessary to verify the sponsoring entity's compliance with such requirements. The IRS may request, for example, a description or copy of the sponsoring entity's policies and procedures for fulfilling the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA, a description or copy of the sponsoring entity's procedures for conducting its periodic review, or a copy of any written reports documenting the findings of such review. The IRS may also request the performance of specified review procedures by a person (including an external auditor or third-party consultant) that the IRS identifies as competent to perform such procedures given the facts and circumstances surrounding the sponsoring entity's potential failure to comply with respect to each sponsored FFI with the requirements of paragraph (f)(1)(i)(F) or (f)(2)(iii) of this section or an applicable Model 2 IGA.

(iii) *Compliance procedures for a sponsored FFI subject to a Model 2 IGA.* In the case of a sponsored FFI subject to the requirements of an applicable Model 2 IGA, the procedures described in paragraph (j)(4) of this section apply, except as otherwise provided in the applicable Model 2 IGA.

(5) *Preexisting account certification.* The responsible officer of a sponsoring entity must make the certification described in §1.1471-4(c)(7) (preexisting account certification of a participating FFI) with respect to each sponsored FFI that enters into the sponsorship agreement with the sponsoring entity during the certification period (as defined in paragraph (j)(3)(iii) of this section). However, the preexisting

account certification is not required for a sponsored FFI that, immediately before the FFI first agrees to be sponsored by the sponsoring entity, was a participating FFI, a sponsored FFI of another sponsoring entity, or a registered deemed-compliant FFI that is a local FFI or a restricted fund, if the FFI (or the FFI's former sponsoring entity, if applicable) provides a written certification to the sponsoring entity that the FFI has made the preexisting account certification required under §1.1471-4(c)(7) or paragraph (f)(1)(i)(A)(7) or (f)(1)(i)(D)(6) of this section (as applicable), unless the sponsoring entity knows that such written certification is unreliable or incorrect. In addition, the preexisting account certification is not required for a sponsored FFI that enters into the sponsorship agreement with the sponsoring entity during the two year period before the end of the sponsoring entity's certification period, provided that the sponsoring entity makes the preexisting account certification for such FFI for the subsequent certification period. The certification described in this paragraph (j)(5) for the certification period must be submitted by the due date of the sponsoring entity's certification of compliance required under paragraph (j)(3)(i) of this section for the certification period (or the extended due date described in paragraph (j)(3)(i)(B) of this section for the certification period ending on December 31, 2017), on the form and in the manner prescribed by the IRS. With respect to a sponsored FFI for which the sponsoring entity makes a preexisting account certification, a preexisting obligation means any account, instrument, or contract (including any debt or equity interest) maintained, executed, or issued by the sponsored FFI that is outstanding on the earlier of the date the FFI is issued a GIIN as a sponsored FFI or the date the FFI first agrees to be sponsored by the sponsoring entity.

(6) *Sponsorship agreement.* A sponsoring entity must have a written sponsorship agreement (which may be part of another agreement between the sponsoring entity and the sponsored FFI) that refers to the requirements of a sponsored FFI under FATCA and that must be in place with each sponsored FFI for which the sponsoring entity acts by the later of March 31, 2019, or the date that the sponsoring entity

begins acting as a sponsoring entity for the applicable sponsored FFI.

(k) *Sponsoring entity event of default*—(1) *Defined*. An event of default with regard to a sponsoring entity occurs if the sponsoring entity fails to perform material obligations required with respect to the due diligence, withholding, and reporting requirements of §1.1471-4 or an applicable Model 2 IGA with respect to any sponsored FFI, to establish or maintain a compliance program as described in paragraph (j)(2) of this section, or to perform a periodic review described in paragraph (j)(2) of this section. An event of default also includes the occurrence of any of the following—

(i) With respect to any sponsored FFI, failure to obtain, in any case in which foreign law would (but for a waiver) prevent the reporting of U.S. accounts required under §1.1471-4(d), valid and effective waivers from holders of U.S. accounts or failure to otherwise close or transfer such U.S. accounts as required under §1.1471-4(i);

(ii) With respect to any sponsored FFI, failure to significantly reduce, over a period of time, the number of account holders or payees that such sponsored FFI is required to treat as recalcitrant account holders or nonparticipating FFIs, as a result of the sponsoring entity failing to comply with the due diligence procedures set forth in §1.1471-4(c);

(iii) With respect to any sponsored FFI, failure to fulfill the requirements of §1.1471-4(i) in any case in which foreign law prevents or otherwise limits withholding under §1.1471-4(b);

(iv) Failure to take timely corrective actions to remedy a material failure described in paragraph (j)(3)(vii) of this section after making a qualified certification described in paragraph (j)(3)(vi)(B) of this section;

(v) Failure to make the preexisting account certification required under paragraph (j)(5) of this section or the periodic certification required under paragraph (j)(3) of this section with respect to any sponsored FFI within the specified time period;

(vi) Making incorrect claims for refund on behalf of any sponsored FFI;

(vii) Failure to cooperate with an IRS request for additional information under paragraph (j)(4) of this section;

(viii) Making any fraudulent statement or misrepresentation of material fact to the IRS or representing to a withholding agent or the IRS its status as a sponsoring entity for an entity other than an entity for which it acts as a sponsoring entity;

(ix) The sponsoring entity is no longer authorized to perform the requirements of a sponsoring entity with respect to one or more sponsored FFIs; or

(x) Failure to have the written sponsorship agreement described in paragraph (j)(3)(v)(B) of this section in effect with each sponsored FFI.

(2) *Notice of event of default*. Following an event of default known by or disclosed by the sponsoring entity to the IRS, the IRS will deliver to the sponsoring entity a notice of default specifying the event of default and, if applicable, identifying each sponsored FFI to which the notice relates. The IRS will request that the sponsoring entity remediate the event of default within 45 days (unless additional time is requested and agreed to by the IRS). The sponsoring entity must respond to the notice of default and provide information responsive to an IRS request for information or state the reasons why the sponsoring entity does not agree that an event of default has occurred.

(3) *Remediation of event of default*. A sponsoring entity will be permitted to remediate an event of default to the extent that it agrees with the IRS on a remediation plan. Such a plan may, for example, allow a sponsoring entity to remediate an event of default described in paragraph (k) (1) of this section with respect to a sponsored FFI by providing specific information regarding the U.S. accounts maintained by such sponsored FFI when the sponsoring entity has been unable to report all of the information with respect to such accounts as required under §1.1471-4(d) and has been unable to close or transfer such accounts. The IRS may, as part of a remediation plan, require additional information from the sponsoring entity or the performance of the specified review procedures described in paragraph (j)(4) (ii) of this section.

(4) *Termination*—(i) *In general*. If the sponsoring entity does not provide a response to a notice of default within the period specified in paragraph (k)(2) of this section or does not remediate the event of

default as described in paragraph (k)(3) of this section, the IRS may deliver a notice of termination that terminates the sponsoring entity's status, the status of one or more sponsored FFIs as deemed-compliant FFIs, or the status of both the sponsoring entity and one or more sponsored FFIs.

(ii) *Termination of sponsoring entity*. If the IRS terminates the status of the sponsoring entity, the sponsoring entity must send notice of the termination within 30 days after the date of termination to each sponsored FFI for which it acts, as well as to each withholding agent from which each sponsored FFI receives payments and each financial institution with which each sponsored FFI holds an account for which a withholding certificate or other documentation was provided. A sponsoring entity that has had its status terminated cannot register on the FATCA registration website to act as a sponsoring entity for any sponsored FFI or for any entity that is a sponsored entity under a Model 1 IGA unless it receives written approval from the IRS to register. Unless the status of a sponsored FFI has been terminated, the sponsored FFI may register on the FATCA registration website as a participating FFI or registered deemed-compliant FFI (as applicable). However, a sponsored FFI whose sponsoring entity has been terminated may not register or represent its status as a sponsored FFI of a sponsoring entity that has a relationship described in section 267(b) or 707(b) with the sponsoring entity that was terminated without receiving written approval from the IRS.

(iii) *Termination of sponsored FFI*. If the IRS notifies the sponsoring entity that the status of a sponsored FFI is terminated (but not the sponsoring entity's status), the sponsoring entity must remove the sponsored FFI from the sponsoring entity's registration account on the FATCA registration website and send notice of the termination within 30 days after the date of termination to each withholding agent from which the sponsored FFI receives payments and each financial institution with which it holds an account for which a withholding certificate or other documentation was provided with respect to such sponsored FFI. A sponsored FFI that has had its status as a sponsored FFI terminated (independent from a termination

of status of its sponsoring entity) may not register on the FATCA registration website as a participating FFI or registered deemed-compliant FFI unless it receives written approval from the IRS.

(iv) *Reconsideration of notice of default or notice of termination.* A sponsoring entity or sponsored FFI may request, within 90 days of a notice of default or notice of termination, reconsideration of the notice of default or notice of termination by written request to the IRS.

(v) *Sponsoring entity of sponsored FFIs subject to a Model 2 IGA.* Subject to the provisions of an applicable Model 2 IGA, the IRS may revoke the status of a sponsoring entity with respect to one or more sponsored FFIs subject to a Model 2 IGA based on the provisions of paragraphs (k)(2), (3), and (4) of this section (describing notice of event of default and termination procedures) if there is an event of default as defined in paragraph (k)(1) of this section.

(l) *Trustee-documented trust verification--(1) Compliance program.* A trustee of a trust treated as a trustee-documented trust under an applicable Model 2 IGA must establish and implement a compliance program for purposes of satisfying the requirements of an applicable Model 2 IGA with respect to each such trust. The trustee must appoint a responsible officer who must (either personally or through designated persons) establish policies, procedures, and processes sufficient for the trustee to implement the compliance program. The responsible officer (or designee) must periodically review the sufficiency of the trustee's compliance program and the trustee's compliance with respect to each trust for purposes of satisfying the requirements of an applicable Model 2 IGA for each certification period described in paragraph (l)(2) of this section. The results of the periodic review must be considered by the responsible officer in making the certification described in paragraph (l)(2) of this section.

(2) *Certification of compliance--(i) Certification requirement--(A) In general.* Except as otherwise provided in paragraph (l)(2)(i)(B) or (l)(2)(ii) of this section, on or before July 1 of the calendar year following the end of the certification period, the responsible officer of the trustee must make a certification for the certification

period with respect to all trustee-documented trusts described in paragraph (l) (1) of this section on the form and in the manner prescribed by the IRS.

(B) *Extension of time for the certification period ending on December 31, 2017.* The certifications required for a certification period ending on December 31, 2017, must be submitted on or before March 31, 2019.

(ii) *Late-joining trustee-documented trusts.* In general, with respect to a certification period, the responsible officer of a trustee is not required to make a certification for a trustee-documented trust for which the trustee first agreed to act as the trustee under Annex II of an applicable IGA during the six-month period before the end of the trustee's certification period, provided that the responsible officer of the trustee makes certifications for such trustee-documented trust for subsequent certification periods and the first such certification covers both the subsequent certification period and the portion of the prior certification period of the trustee during which the trustee acted as the trustee of the trustee-documented trust. However, the preceding sentence does not apply to a trustee-documented trust that, immediately before the trustee first agrees to act as the trustee under Annex II of an applicable IGA, was a trustee-documented trust of another trustee. The trustee of a trustee-documented trust may certify for a trustee-documented trust described in the preceding sentence for the portion of the certification period of the trustee before the date that the trustee first agrees to act as the trustee under Annex II of an applicable IGA if the trustee obtains from the trustee-documented trust (or the trust's former trustee, if applicable) a written certification that the trust has complied with its applicable chapter 4 requirements during such portion of the certification period, provided that: the trustee does not know that such certification is unreliable or incorrect; and the certification for the trustee-documented trust for the subsequent certification period covers both the subsequent certification period and the portion of the prior certification period during which the trustee acts as the trustee under Annex II of an applicable IGA.

(iii) *Certification period.* The first certification period of the trustee begins on

the later of the date the trustee is issued a GIIN to act as a trustee of a trustee-documented trust or June 30, 2014, and ends at the close of the third full calendar year following such date. Each subsequent certification period is the three-calendar-year period following the previous certification period.

(iv) *Certifications.* The responsible officer of the trustee must certify to the following statements--

(A) The responsible officer of the trustee has established a compliance program that is in effect as of the date of the certification and has performed a periodic review described in paragraph (l)(1) of this section for the certification period; and

(B) The trustee has reported to the IRS on Form 8966, "FATCA Report" (or such other form as the IRS may prescribe), all of the information required to be reported pursuant to the applicable Model 2 IGA with respect to all U.S. accounts of each trustee-documented trust for which the trustee acts during the certification period by the due date of Form 8966 (including extensions) for each year.

(3) *IRS review of compliance by trustees of trustee-documented trusts--(i) General inquiries.* Based upon the information reporting forms filed with the IRS (or the absence of such reporting) by a trustee with respect to any trustee-documented trust subject to a Model 2 IGA for each calendar year, and subject to the requirements of an applicable Model 2 IGA, the IRS may request from the trustee additional information with respect to the information reported on the forms with respect to any trustee-documented trust or a confirmation that the trustee has no reporting requirements with respect to any trustee-documented trust. The IRS may also request any additional information to determine the trustee's compliance for purposes of satisfying the trust's requirements as a trustee-documented trust under an applicable Model 2 IGA or to assist the IRS with its review of account holder compliance with tax reporting requirements.

(ii) *Inquiries regarding substantial non-compliance.* The IRS may determine in its discretion that the trustee may not have substantially complied with the requirements applicable to a trustee of a trustee-documented trust. This determina-



tion is based on the information reporting forms filed with the IRS by a trustee with respect to any trustee-documented trust subject to a Model 2 IGA for each calendar year (or the absence of such reporting), the certification described in paragraph (l) (2) of this section (or the absence of such certification), or any other information related to the trustee's compliance with respect to any trustee-documented trust for purposes of satisfying the trust's applicable Model 2 IGA requirements. In such a case, the IRS may request from the responsible officer information necessary to verify the trustee's compliance with such requirements. The IRS may also request the performance of specified review procedures by a person (including an external auditor or third-party consultant) that the IRS identifies as competent to perform such procedures given the circumstances surrounding the trustee's potential failure to comply with the requirements of an applicable Model 2 IGA with respect to one or more trustee-documented trusts. The IRS may notify the applicable Model 2 IGA jurisdiction that the trustee has not complied with its requirements as a trustee of one or more trustee-documented trusts.

(m) *Applicability date.* This section generally applies beginning on January 6, 2017, except for paragraphs (f)(1)(i) (F)(3)(vi), (f)(1)(i)(F)(4), (f)(1)(iv), (f)(2) (iii)(D)(4), (f)(2)(iii)(E), (j), (k), and (l) of this section, which apply March 25, 2019. However, taxpayers may apply these provisions as of January 28, 2013. (For the rules that otherwise apply beginning on January 6, 2017, and before March 25, 2019, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2018. For the rules that otherwise apply beginning on January 28, 2013, and before January 6, 2017, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2016.)

Par. 6. Section 1.1472-1 is amended by revising paragraphs (c)(5)(iii), (f), (g), and (h) to read as follows:

*§1.1472-1 Withholding on NFFEs.*

\* \* \* \* \*

(c) \* \* \*

(5) \* \* \*

(iii) *Revocation of status as sponsoring entity.* The IRS may revoke a sponsoring

entity's status as a sponsoring entity with respect to all sponsored direct reporting NFFEs if there is an event of default as defined in paragraph (g) of this section with respect to any sponsored direct reporting NFFE.

\* \* \* \* \*

(f) *Sponsoring entity verification--(1) In general.* This paragraph (f) describes the requirements for a sponsoring entity to provide a certification of compliance with respect to each sponsored direct reporting NFFE for purposes of satisfying the requirements of paragraph (c)(5) of this section and defines the certification period for such certifications. This paragraph (f) also describes the procedures for the IRS to review the sponsoring entity's compliance with such requirements during the certification period. Finally, this paragraph (f) describes the requirement that a sponsoring entity have in place a written sponsorship agreement with each sponsored direct reporting NFFE for which it acts and specifies the terms of such agreement. See paragraph (g)(1)(i) of this section, describing an event of default for a sponsoring entity that does not have a sponsorship agreement with each sponsored direct reporting NFFE for which it acts as a sponsoring entity. References in this paragraph (f) or paragraph (g) of this section to a sponsored direct reporting NFFE mean a sponsored direct reporting NFFE for which the sponsoring entity acts as a sponsoring entity under paragraph (c) (5)(ii) of this section.

(2) *Certification of compliance--(i) Certification requirement--(A) In general.* The sponsoring entity must appoint a responsible officer to oversee the sponsoring entity's compliance with respect to each sponsored direct reporting NFFE for purposes of satisfying the requirements of paragraph (c)(5) of this section. Except as otherwise provided in paragraph (f)(2)(i) (B) or (f)(2)(ii) of this section, on or before July 1 of the calendar year following the certification period, the responsible officer of the sponsoring entity must make a certification for the certification period with respect to all sponsored direct reporting NFFEs for which the sponsoring entity acts during the certification period on the form and in the manner prescribed by the IRS. To the extent that a sponsoring entity satisfies the certification require-

ments of paragraph (f)(2) of this section on behalf of a sponsored direct reporting NFFE, the NFFE does not have a certification requirement under paragraph (c)(3) (vi) of this section.

(B) *Extension of time for the certification period ending on December 31, 2017.* The certifications required for a certification period ending on December 31, 2017, must be submitted on or before March 31, 2019.

(ii) *Late-joining sponsored direct reporting NFFEs.* In general, with respect to a certification period, a sponsoring entity is not required to make a certification for a sponsored direct reporting NFFE that first agrees to be sponsored by the sponsoring entity during the six-month period before the end of the sponsoring entity's certification period, provided that the sponsoring entity makes certifications for such sponsored direct reporting NFFE for subsequent certification periods, and the first such certification covers both the subsequent certification period and the portion of the prior certification period of the sponsoring entity during which the sponsored direct reporting NFFE was sponsored by the sponsoring entity. However, the preceding sentence does not apply to a sponsored direct reporting NFFE that, immediately before the NFFE agrees to be sponsored by the sponsoring entity, was a direct reporting NFFE or sponsored direct reporting NFFE of another sponsoring entity. The sponsoring entity may certify for a sponsored direct reporting NFFE described in the preceding sentence for the portion of the certification period of the sponsoring entity before the date that the NFFE first agrees to be sponsored by the sponsoring entity if the sponsoring entity obtains from the NFFE (or the NFFE's sponsoring entity, if applicable) a written certification that the NFFE has complied with its applicable chapter 4 requirements during such portion of the certification period, provided that: the sponsoring entity does not know that such certification is unreliable or incorrect; and the certification for the sponsored direct reporting NFFE for the subsequent certification period covers both the subsequent certification period and the portion of the prior certification period during which such NFFE was sponsored by the sponsoring entity.



(iii) *Certification period.* The first certification period of a sponsoring entity begins on the later of the date the sponsoring entity is issued a GIIN to act as a sponsoring entity or June 30, 2014, and ends at the close of the third full calendar year after such date. Each subsequent certification period is the three-calendar-year period following the close of the previous certification period.

(iv) *Certifications.* The certification will require the responsible officer of the sponsoring entity to certify to the following statements--

(A) The sponsoring entity meets all of the requirements of a sponsoring entity described in paragraph (c)(5)(ii) of this section;

(B) The sponsoring entity has the written sponsorship agreement described in paragraph (f)(4) of this section in effect with each sponsored direct reporting NFFE;

(C) There were no events of default (as defined in paragraph (g) of this section) with respect to the sponsoring entity, or, to the extent there were any such events of default, appropriate measures were taken by the sponsoring entity to remediate and prevent such events from reoccurring; and

(D) With respect to any failure to report to the extent required under paragraph (c)(3)(ii) of this section with respect to one or more sponsored direct reporting NFFEs, the sponsoring entity has corrected such failure by filing the appropriate information returns.

(3) *IRS review of compliance--(i) General inquiries.* The IRS, based upon the information reporting forms described in paragraph (c)(3)(ii) of this section filed with the IRS (or the absence of such reporting) by the sponsoring entity for each calendar year with respect to any sponsored direct reporting NFFE, may request additional information with respect to the information reported (or required to be reported) on the forms about any substantial U.S. owner reported on the form or the records for each direct reporting NFFE described in paragraph (c)(3)(iv) of this section. The IRS may also request any additional information from the sponsoring entity (including a copy of each sponsorship agreement the sponsoring entity has

entered into with each sponsored FFI) to determine its compliance with paragraph (f) of this section with respect to each sponsored direct reporting NFFE and to assist the IRS with its review of any substantial U.S. owners' compliance with tax reporting requirements.

(ii) *Inquiries regarding substantial non-compliance.* The IRS may determine in its discretion that a sponsoring entity may not have substantially complied with the requirements of a sponsoring entity with respect to each sponsored direct reporting NFFE for purposes of satisfying the requirements of paragraph (c)(5) of this section. This determination is based on the information reporting forms referenced in paragraph (c)(3)(ii) of this section filed with the IRS by the sponsoring entity for each calendar year with respect to any sponsored direct reporting NFFE (or the absence of such reporting), the certification made by the responsible officer described in paragraph (f)(2) of this section (or the absence of such certification), or any other information related to the sponsoring entity's compliance with the requirements of a sponsoring entity with respect to each sponsored direct reporting NFFE for purposes of satisfying the requirements of paragraph (c)(5) of this section. In such a case, the IRS may request from the responsible officer information necessary to verify the sponsoring entity's compliance with such requirements. The IRS may also request the performance of specified review procedures by a person (including an external auditor or third-party consultant) that the IRS identifies as competent to perform such procedures given the circumstances surrounding the sponsoring entity's potential failure to comply with the requirements of a sponsoring entity.

(4) *Sponsorship agreement.* The sponsoring entity must have a written sponsorship agreement (which may be part of another agreement between the sponsoring entity and the sponsored direct reporting NFFE) in place with each sponsored direct reporting NFFE for which it acts by the later of March 31, 2019, or the date that the sponsoring entity begins acting as a sponsoring entity for the applicable sponsored direct reporting NFFE, under which--

(i) The sponsored direct reporting NFFE agrees to provide the sponsoring entity access to the sponsored direct reporting NFFE's books and records regarding each of its owners (including AML/KYC documentation regarding the sponsored direct reporting NFFE's owners provided by the sponsored direct reporting NFFE with respect to each financial account it holds) and such other information sufficient for the sponsoring entity to determine the direct and indirect substantial U.S. owners of the sponsored direct reporting NFFE, including the information about such owners required under paragraph (c)(3)(ii) of this section to be reported on Form 8966, "FATCA Report" (or such other form as the IRS may prescribe);

(ii) The sponsored direct reporting NFFE obtains a valid and effective waiver of any legal prohibitions on reporting the information about its direct and indirect substantial U.S. owners required under paragraph (c)(3)(ii) of this section to be reported on Form 8966 (or such other form as the IRS may prescribe);

(iii) The sponsored direct reporting NFFE authorizes the sponsoring entity to act on the sponsored direct reporting NFFE's behalf with respect to the sponsored direct reporting NFFE's obligations as a sponsored direct reporting NFFE (for example, authorizing the sponsoring entity to file Form 8966 on the sponsored direct reporting NFFE's behalf, responding to the IRS inquiries described in paragraph (f)(3) of this section, and providing the certification described in paragraph (f)(2) of this section);

(iv) The sponsored direct reporting NFFE agrees to identify to the sponsoring entity on request each withholding agent and financial institution to which the sponsored direct reporting NFFE reports its status as a sponsored direct reporting NFFE and agrees to provide to the sponsoring entity a copy of the withholding certificate or written statement prescribed in §1.1471-3(d)(11)(x)(B) (as applicable) that the sponsored direct reporting NFFE provides to each such withholding agent or financial institution;

(v) The sponsored direct reporting NFFE represents that it does not have any

formal or informal practices or procedures to assist its substantial U.S. owners with the avoidance of the requirements of chapter 4;

(vi) The sponsored direct reporting NFFE agrees to cooperate with the sponsoring entity in responding to any IRS inquiries under paragraph (f)(3) of this section with respect to the sponsored direct reporting NFFE; and

(vii) The sponsoring entity retains the records described in paragraphs (c)(3)(iii) and (iv) of this section for the longer of six years or the retention period under the sponsoring entity's normal business procedures. A sponsoring entity may be required to extend the retention period if the IRS requests such an extension before the expiration of the period.

(g) *Sponsoring entity event of default--*(1) *Defined.* An event of default by the sponsoring entity means the occurrence of any of the following--

(i) Failure to have the written sponsorship agreement described in paragraph (f)(4) of this section in effect with each sponsored direct reporting NFFE;

(ii) Failure to satisfy the requirements of paragraph (c)(3)(iii) of this section with respect to each sponsored direct reporting NFFE that the NFFE would have been required to satisfy as a direct reporting NFFE;

(iii) Failure to report to the IRS on Form 8966, "FATCA Report," (or such other form as the IRS may prescribe) all of the information required under paragraph (c)(3)(ii) of this section with respect to each sponsored direct reporting NFFE and each of its substantial U.S. owners (or report to the IRS on Form 8966 that the sponsored direct reporting NFFE had no substantial U.S. owners) by the due date of the form (including any extensions);

(iv) Failure to make the certification required under paragraph (f)(2) of this section;

(v) Failure to cooperate with an IRS request for additional information described in paragraph (f)(3) of this section, including requests for the records described in paragraph (c)(3)(iv) of this section and requests to extend the retention period for these records as described in (f)(4)(vii) of this section;

(vi) Making any fraudulent statement or misrepresentation of material fact to the IRS or representing to a withholding agent or the IRS its status as a sponsoring entity under paragraph (c)(5) of this section for an entity other than an entity for which it acts as a sponsoring entity; or

(vii) Failure to obtain from each sponsored direct reporting NFFE the information required to report on Form 8966.

(2) *Notice of event of default.* Following an event of default known by or disclosed to the IRS, the IRS will deliver to the sponsoring entity a notice of default specifying the event of default and, if applicable, identifying each sponsored direct reporting NFFE to which the notice relates. The IRS will request that the sponsoring entity remediate the event of default within 45 days (unless additional time is requested and agreed to by the IRS). The sponsoring entity must respond to the notice of default and provide information responsive to an IRS request for information or state the reasons why the sponsoring entity does not agree that an event of default has occurred.

(3) *Remediation of event of default.* A sponsoring entity will be permitted to remediate an event of default to the extent that it agrees with the IRS on a remediation plan. The IRS may, as part of a remediation plan, require additional information from the sponsoring entity, remedial actions, or the performance of the specified review procedures described in paragraph (f)(3)(ii) of this section.

(4) *Termination--*(i) *In general.* If the sponsoring entity does not provide a response to a notice of default within the period specified in paragraph (g)(2) of this section, or if the sponsoring entity does not satisfy the conditions of the remediation plan within the time period specified by the IRS, the IRS may deliver a notice of termination that terminates the sponsoring entity's status, the status of one or more sponsored direct reporting NFFEs as a direct reporting NFFE, or the status of both the sponsoring entity and one or more sponsored direct reporting NFFEs.

(ii) *Termination of sponsoring entity.* If the IRS notifies the sponsoring entity that its status is terminated, the sponsoring entity must send notice of the termination within 30 days after the date of ter-

mination to each withholding agent from which each sponsored direct reporting NFFE receives payments and each financial institution with which each sponsored direct reporting NFFE holds an account for which a withholding certificate or written statement prescribed in §1.1471-3(d)(11)(x)(B) (as applicable) was provided. A sponsoring entity that has had its status terminated cannot reregister on the FATCA registration website to act as a sponsoring entity for any sponsored direct reporting NFFE unless it receives written approval from the IRS. Unless the status of the sponsored direct reporting NFFEs has been terminated, the sponsored direct reporting NFFEs may register on the FATCA registration website as direct reporting NFFEs or as sponsored direct reporting NFFEs of another sponsoring entity, other than a sponsoring entity that is related to the sponsoring entity that was terminated (absent written approval from the IRS allowing the registration). An entity is related to the terminated sponsoring entity if they have a relationship with each other that is described in section 267(b) or 707(b).

(iii) *Termination of sponsored direct reporting NFFE.* If the IRS notifies the sponsoring entity that the status of a sponsored direct reporting NFFE is terminated (but not the sponsoring entity's status), the sponsoring entity must remove the sponsored direct reporting NFFE from the sponsoring entity's registration account on the FATCA registration website and send notice of the termination within 30 days after the date of termination to each withholding agent from which the sponsored direct reporting NFFE receives payments and each financial institution with which it holds an account for which a withholding certificate or written statement prescribed in §1.1471-3(d)(11)(x)(B) (as applicable) was provided with respect to such sponsored direct reporting NFFE. A sponsored direct reporting NFFE that has had its status as a sponsored direct reporting NFFE terminated (independent from a termination of status of its sponsoring entity) may not register on the FATCA registration website as a direct reporting NFFE or as a sponsored direct reporting NFFE of another sponsoring entity unless it receives written approval from the IRS.

(iv) *Reconsideration of notice of default or notice of termination.* A sponsoring entity or sponsored direct reporting NFFE may request, within 90 days of a notice of default or notice of termination, reconsideration of the notice of default or notice of termination by written request to the IRS.

(h) *Applicability date.* This section generally applies beginning on January 6, 2017, except for paragraphs (c)(5)(iii), (f), and (g) of this section, which apply March 25, 2019. However, taxpayers may apply these provisions as of January 28, 2013. (For the rules that otherwise apply beginning on January 6, 2017, and before March 25, 2019, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2018. For rules that otherwise apply beginning on January 28, 2013, and before January 6, 2017, see this section as in effect and contained in 26 CFR part 1 revised April 1, 2016.)

Kirsten Wielobob,  
*Deputy Commissioner for Services  
and Enforcement.*

Approved: February 27, 2019.

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

(Filed by the Office of the Federal Register on March 21, 2019, 4:15 p.m., and published in the issue of the Federal Register for March 25, 2019, 84 F.R. 10976)

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*26 CFR 301.6707A-1: Failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction*

## **T.D. 9853**

### **DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301**

### **Reportable Transactions Penalties under Section 6707A**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

**SUMMARY:** This document contains final regulations that provide guidance regarding the amount of the penalty under section 6707A of the Internal Revenue Code (Code) for failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction. The final regulations are necessary to clarify the amount of the penalty under section 6707A, as amended by the Small Business Jobs Act of 2010. The final regulations will affect any taxpayer who fails to properly disclose participation in a reportable transaction.

**DATES: Effective Date:** These regulations are effective on March 26, 2019.

**FOR FURTHER INFORMATION CONTACT:** Concerning the final regulations, Michael Franklin, (202) 317-6844 (not a toll-free number).

#### **SUPPLEMENTARY INFORMATION:**

##### **Background**

This document contains final regulations amending 26 CFR part 301 under section 6707A of the Internal Revenue Code. Section 6707A was added to the Code by section 811(a) of the American Jobs Creation Act of 2004 (Pub. L. No. 108-357, 118 Stat. 1418) and was amended by section 11(a)(41) of the Tax Technical Corrections Act of 2007 (Pub. L. No. 110-172, 121 Stat. 2473). Section 6707A imposes a penalty for failure to disclose a reportable transaction. It also imposes a penalty on certain taxpayers for failure to disclose in filings with the Securities and Exchange Commission (SEC) any requirement to pay a penalty under (1) section 6707A with respect to a listed transaction, (2) section 6662A with respect to an undisclosed reportable transaction, or (3) section 6662(h) with respect to an undisclosed reportable transaction. On September 11, 2008, temporary regulations (TD 9425) under section 6707A were published in the **Federal Register** (73 FR 52784). A notice of proposed rulemaking (REG-160868-04) cross-referencing the temporary regulations was published in the **Federal Register** on the same day (73 FR 52805).

Section 6707A was amended in 2010 by section 2041(a) of the Small Business Jobs Act of 2010 (Public Law No. 111-240, 124 Stat. 2504) (the Jobs Act), which changed the amount of the penalty from a stated dollar amount to a percentage of the decrease in tax shown on the return as a result of a reportable transaction and provided maximum and minimum penalty amounts. Before the Jobs Act was enacted, the penalty was \$10,000 in the case of a natural person (\$50,000 in any other case) and, in the case of a listed transaction, \$100,000 in the case of a natural person (\$200,000 in any other case). In some cases, this structure resulted in penalties that were potentially disproportionate to the tax benefit derived from the transaction. See “Legislative Recommendations with Legislative Action: Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact,” National Taxpayer Advocate 2008 Annual Report to Congress vol. 1, at 419. In response, Congress amended section 6707A(b) through the Jobs Act. See Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress (JCS-2-11), March 2011 (explaining the reasons for the change to section 6707A).

The Jobs Act amended section 6707A(b) to make the penalty 75 percent of the decrease in tax shown on the return as a result of a reportable transaction, with a minimum penalty amount of \$10,000 (\$5,000 in the case of a natural person). The maximum penalty amount is \$200,000 (\$100,000 in the case of a natural person) for failure to disclose a listed transaction, or \$50,000 (\$10,000 in the case of a natural person) for failure to disclose any other reportable transaction. The Jobs Act amendment applies to penalties assessed after December 31, 2006. See Jobs Act § 2041(b), 124 Stat. at 2560.

On September 7, 2011, final regulations (TD 9550) were published in the **Federal Register** (76 FR 55256) adopting and amending the proposed regulations published on September 11, 2008. The final regulations in TD 9550 did not provide guidance on the amount of the penalty as amended by the Jobs Act beyond reciting the language of section 6707A because the notice of proposed rulemaking on which those final regulations were based predated the Jobs Act.



On August 28, 2015, the Treasury Department and the IRS published in the **Federal Register** (80 FR 52231-01) a notice of proposed rulemaking proposing amendments to regulations under 26 CFR part 301 to provide guidance on the amount of the penalty under section 6707A, as amended by the Jobs Act.

### Summary of Comments and Explanation of Revisions

One electronic comment was submitted under the regulation number for the proposed regulations. The comment is available for public inspection at <http://www.regulations.gov> or upon request. The IRS received no requests for a public hearing, and none was held.

The comment addressed two different issues, the first being the definition of “decrease in tax” provided in §301.6707A-1(d)(1)(i) of the proposed regulations. Section 6707A(b)(1) provides that, subject to certain minimum and maximum amounts, the amount of the penalty under subsection (a) of section 6707A with respect to any reportable transaction shall be 75 percent of the decrease in tax shown on the return as a result of such transaction (or which would have resulted from such transaction if such transaction were respected for federal tax purposes). Section 301.6707A-1(d)(1)(i) of the proposed regulations defines a “decrease in tax” generally as the difference between the amount of tax reported on the return as filed and the amount of tax that would be reported on a hypothetical return where the taxpayer did not participate in the reportable transaction. The definition in §301.6707A-1(d)(1)(i) also encompasses situations where a taxpayer’s participation in a reportable transaction creates a liability for a tax that would not exist absent participation in the transaction. For example, a taxpayer engaging in a listed transaction involving a Roth IRA may be subject to an excise tax on excess IRA contributions. If the taxpayer fails to report the excise tax on the taxpayer’s excess IRA contributions, this amount of tax would not appear on the return filed by the taxpayer that reflected the taxpayer’s participation in the reportable transaction. The excise tax would also not appear on a return filed by the taxpayer if the tax-

payer had not engaged in the transaction, because there would be no excess contribution on which the excise tax would be imposed. Therefore, the difference between these two returns would result in no decrease in tax attributable to the abusive Roth IRA transaction. To account for this type of situation, §301.6707A-1(d)(1)(i)(B) of the proposed regulations includes in the definition of decrease in tax “any other tax that results from participation in the reportable transaction but was not reported on the taxpayer’s return.” *Example 1* in §301.6707A-1(d)(3)(i) illustrates this rule.

The commenter noted that the proposed regulation includes tax that should have been shown on the return, but was not, in the definition of “decrease in tax” described in §301.6707A-1(d)(1)(i)(B) of the proposed regulations. The decrease in tax described in §301.6707A-1(d)(1)(i)(B) of the proposed regulations will only exist if the taxpayer’s reporting position is invalid. If the taxpayer’s reporting position were determined to be correct, there would be no additional tax resulting from the participation in the reportable transaction that the taxpayer was required to, but did not, report on the taxpayer’s return. The commenter contended that including this unreported tax as part of the decrease in tax used to calculate the penalty conflicts with the common understanding that the section 6707A penalty is intended to apply even if the taxpayer’s reporting position is determined to be correct. In this situation, the Service will not be able to impose the penalty without first determining the merits of the reporting position. The commenter expressed concerns about whether Congress intended for the penalty to apply in such circumstances, absent adjudication on the merits of the underlying reporting position. The commenter noted that, in contrast, §301.6707A-1(d)(1)(i)(A) of the proposed regulations defines “decrease in tax” by comparing the amount reported on the taxpayer’s return (reflecting participation in the reportable transaction) with the tax liability that would be reported on a hypothetical return that did not reflect participation in the reportable transaction. This portion of the definition is not affected by the assumption that the taxpayer’s reporting position is invalid.

The definition of “decrease in tax” in §301.6707A-1(d)(1)(i) of the proposed regulations remains the same in the final regulations. The plain language of section 6707A supports the definition of decrease in tax provided in these final regulations. As noted above, section 6707A(b)(1) provides that the amount of the section 6707A penalty “shall be 75 percent of the decrease in tax shown on the return as a result of such transaction.” It is entirely consistent with this statutory language to include, when determining the “decrease in tax” upon which the amount of the penalty is calculated, other tax that would result from participation in the reportable transaction and that was not reported on the taxpayer’s return. If the taxpayer’s participation in the reportable transaction resulted in a decrease in the amount of tax reported on the return, the plain language of section 6707A allows that amount to be taken into account in determining the amount of the section 6707A penalty.

The same commenter also suggested adding an additional factor to the list of factors that the IRS considers when determining whether to rescind a section 6707A penalty in §301.6707A-1(e)(3) of the final regulations (§301.6707A-1(d)(3) in the previous version of these regulations). The commenter suggested adding the filing of a timely amended return that removes the tax benefits claimed with respect to the reportable transaction to that list of factors. The commenter expressed concern that taxpayers might mistakenly believe that they can remedy the failure to disclose the reportable transaction by filing an amended return that does not report the benefits of the transaction and that the filing of such amended return renders moot any obligation to disclose participation in the reportable transaction.

The final regulations do not adopt this suggestion. The section 6707A penalty applies when a taxpayer fails to report participation in a reportable transaction as required under section 6011. The filing of an amended return that does not report the benefits of the reportable transaction does not remedy the failure to which the section 6707A penalty applies, namely the failure to report participation in the reportable transaction. Furthermore, the list of factors in §301.6707A-1(e)(3) that the IRS considers in deciding whether to



rescind a section 6707A penalty is not exclusive. The IRS is not precluded from considering factors other than those listed in the regulation, including the filing of an amended return.

Although no changes were made specifically in response to public comments, some revisions were made to the proposed regulations. Section 301.6707A-1(d)(1)(ii) was revised to clarify how the penalty is calculated in situations where a transaction becomes reportable after the filing of the return or returns reflecting participation in the transaction.

Section 1.6011-4(a) provides that every taxpayer that has participated in a reportable transaction and who is required to file a tax return must file within the time prescribed in §1.6011-4(e) a disclosure statement in the form prescribed by §1.6011-4(d). If a transaction becomes a listed transaction or a transaction of interest after the filing of the return or returns reflecting a taxpayer's participation in such transaction but while the period of limitations on assessment remains open for any year in which the taxpayer participated in the transaction, §1.6011-4(e)(2)(i) requires the taxpayer to file a single disclosure statement with respect to the taxpayer's participation in the transaction with the Office of Tax Shelter Analysis (OTSA) within 90 calendar days after the date on which the transaction became a listed transaction or a transaction of interest. In order for a disclosure statement to be considered complete, §1.6011-4(d) requires the disclosure statement to describe the expected tax treatment and all potential tax benefits expected to result from the transaction, describe any tax result protection with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the transaction and the identity of all parties involved in the transaction.

Section 1.6011-4(e)(2)(i) requires taxpayers to file a single disclosure statement with respect to a subsequently listed transaction or transaction of interest if the period of limitations on assessment remains open with respect to any year in which the taxpayer participated in the reportable transaction. Therefore, a taxpayer that first participated in a listed transaction or transaction of interest during a year for the

which the period of limitations on assessment is closed at the time the transaction becomes reportable, but that also participated in the same reportable transaction during a year for which the period of limitations on assessment remains open at the time the transaction becomes reportable, is required to describe participation in that reportable transaction during years for which the period of limitations is closed at the time the transaction becomes reportable.

In the final regulations, §301.6707A-1(d)(1)(ii) is revised to clarify that, when a taxpayer whose participation in a subsequently identified listed transaction or transaction of interest is reflected on more than one return and when that taxpayer fails to file, as required by §1.6011-4(a), a complete and proper disclosure statement in the time prescribed under §1.6011-4(e)(2)(i), the amount of the penalty will be calculated by aggregating the decrease in tax shown on each return for which the period of limitations on assessment remains open at the time the transaction becomes reportable, subject to the statutory minimum and maximum penalty amounts. Decreases in tax shown on returns for years for which the period of limitations is not open at the time the transaction becomes reportable will not be taken into account in calculating the amount of the penalty. *Example 5* in §301.6707A-1(d)(3)(v) is revised to more clearly illustrate how the penalty is calculated in situations where a taxpayer fails to disclose participation in a subsequently identified transaction.

Section 6501, which prescribes the period of limitation for assessment of tax, does not preclude the IRS from taking into account decreases in tax shown on returns for which the period of limitations has closed when calculating the amount of the penalty. However, in the interest of providing to taxpayers the repose generally provided for by the expiration of the period of limitations on assessment, these final regulations adopt an approach wherein those amounts are not taken into account in calculating the penalty. When a transaction becomes reportable after the filing of the return or returns reflecting participation in that transaction, the obligation to file a disclosure statement does not arise until the transaction becomes a

listed transaction or transaction of interest. When the transaction becomes a listed transaction or transaction of interest, the taxpayer then has 90 calendar days to file a complete and accurate disclosure statement with the OTSA. It is the failure to file this disclosure statement that gives rise to liability for a single section 6707A penalty.

The approach to calculating the penalty adopted in these final regulations is also more administrable. By including in the calculation of the penalty only decreases in tax shown on returns for which the period of limitations on assessment remains open, there is certainty about which returns need to be reviewed and which decreases in tax are taken into account in calculating the amount of the penalty. If decreases in tax reported on returns for tax years for which the period of limitations on assessment is closed were taken into account in calculating the amount of the penalty, an indefinite number of prior year returns would have to be reviewed to determine whether the return reflects participation in the reportable transaction and to correctly calculate the penalty. The approach adopted in these regulations avoids this uncertainty, providing uniformity and repose to both taxpayers and the IRS.

In addition to the changes to §301.6707A-1(d)(1)(ii), one additional example was added to §301.6707A-1(d)(3)(vii) of the final regulations. *Example 7* illustrates the application of the penalty in situations where a taxpayer that fails to disclose a subsequently listed transaction files an amended return again reporting the tax benefits associated with that transaction but does not disclose participation in the transaction on the amended return as required by §1.6011-4. Further, all examples were updated and revised for clarity with non-substantive changes.

## Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Because the final regulations would not impose a collection of information on small entities, the Regu-

latory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. No comments were received on the proposed regulations.

## Drafting Information

The principal author of these regulations is Michael Franklin of the Office of the Associate Chief Counsel (Procedure and Administration).

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## Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

### PART 301--PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.6707A-1 is amended by:

1. Adding paragraph (b)(3).
2. In paragraph (c)(1), removing the language “(including an amended return or application for tentative refund)” in the fifth sentence.
3. Redesignating paragraphs (d), (e) and (f) as paragraphs (e), (f), and (g).
4. Adding new paragraph (d).
5. In newly designated paragraph (e), removing “(d)(3)(i)” and “(d)(3)” wherever they appear and adding “(e)(3)(i)” and “(e)(3)” in their place, respectively.
6. In newly designated paragraph (e)(3)(i), removing the language “(including an amended return or application for tentative refund)” wherever it appears.
7. In newly designated paragraph (f), removing “(e)(1)”, “(e)(2)”, “(e)(3)”, and “(e)(1)(i) through (e)(1)(iii)” wherever they appear and adding “(f)(1)”, “(f)(2)”, “(f)(3)”, and “(f)(1)(i) through (iii)” in their place, respectively.
8. Revising newly designated paragraph (g).

The additions and revisions read as follows:

§ 301.6707A-1. *Failure to include on any return or statement any information required to be disclosed under section 6011 with respect to a reportable transaction.*

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(b) \* \* \*

(3) *Return.* For purposes of this section, the term *return* means an original return, amended return, or application for tentative refund, except where otherwise indicated. As used in examples, the term *return* means an original return, except where otherwise indicated.

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(d) *Calculation of the penalty--*(1) *Decrease in tax--*(i) *In general.* (A) As used in this section, the phrase *decrease in tax shown on the return as a result of the transaction or the decrease that would have resulted from the transaction if it were respected for Federal tax purposes* means the sum of:

(1) The excess of the amount of the tax that would have been shown on the return if the return did not reflect the taxpayer's participation in the reportable transaction over the tax actually reported on the return reflecting participation in the reportable transaction; and

(2) Any other tax that results from participation in the reportable transaction but was not reported on the taxpayer's return.

(B) The amount of tax that would have been shown on the return if it did not reflect the taxpayer's participation in the reportable transaction includes adjustments that result mechanically from backing out the reportable transaction, such as tax items affected by an increase in adjusted gross income resulting from not participating in the transaction. The calculation of the penalty is unaffected by whether a taxpayer's tax liability is ultimately settled with the IRS for a different amount or whether the taxpayer subsequently reports a different amount of tax on an amended return, because these amounts do not enter into the calculation of the decrease in tax shown on the return (or returns) to which the penalty relates.

(ii) *Subsequently identified transactions.* If the taxpayer fails to file, as required by § 1.6011-4(a) of this chapter, a

complete and proper disclosure statement disclosing participation in a listed transaction or transaction of interest with respect to more than one return in the time prescribed under § 1.6011-4(e)(2)(i) of this chapter, the amount of the penalty will be computed by aggregating the decrease in tax shown on each return for which the period of limitations on assessment remains open.

(iii) *Penalty for failure to report to the SEC.* In the case of a penalty imposed under section 6707A(e) for failure to disclose liability for certain penalties in reports to the Securities and Exchange Commission (SEC), the amount of the penalty will be determined under section 6707A(b) and this paragraph (d), regardless of whether the penalty that the taxpayer failed to disclose is imposed under section 6707A, 6662A, or 6662(h).

(iv) *Minimum and maximum amount of the penalty.* The limitations on the minimum and maximum penalty amounts described in paragraph (a) of this section apply separately to each failure to disclose that is subject to a penalty.

(2) *No tax required to be shown on return.* For returns with respect to which disclosure is required but on which no tax is required to be shown (for example, returns of passthrough entities), the minimum penalty amount will be imposed for the failure to disclose.

(3) *Examples.* The rules in paragraphs (d)(1) and (2) of this section are illustrated by the following examples:

(i) *Example 1.* Taxpayer X, a natural person, participated in a listed transaction involving a Roth IRA and filed a return reflecting participation in the transaction. X failed to disclose participation in the listed transaction as required by the regulations under section 6011. As a result of the transaction, X was liable under section 4973 for a \$10,000 excise tax for excess contributions to X's Roth IRA. On X's return reflecting participation in the listed transaction, X correctly reported \$25,000 of income tax, none of which was attributable to the listed transaction, but failed to report the excise tax. If X had not participated in the listed transaction, the excise tax under section 4973 would not have applied and X's income tax would have remained \$25,000. There would, therefore, be no difference between the tax on the return as filed and the tax on the return if it did not reflect participation in the transaction. The excise tax, however, is another tax that resulted from participation in the transaction but was not reported on X's return, as described in paragraph (d)(1)(i)(B) of this section. Therefore, under paragraph (d)(1) of this section, the decrease in tax resulting from the listed transaction is \$10,000. This amount is deter-

mined by adding zero (the excess of the amount of tax that would have been shown on X's return if the return did not reflect X's participation in the transaction over the tax X actually reported on the return reflecting X's participation in the transaction) and \$10,000 (the amount of excise tax that resulted from participation in the transaction but was not reported on the return). The amount of the penalty under section 6707A is \$7,500, which amount is 75 percent of the \$10,000 decrease in tax.

(ii) *Example 2.* Taxpayer X participated in a listed transaction that resulted in a \$40,000 decrease in the tax shown on the return reflecting participation in the transaction. X failed to disclose its participation in the transaction as required by the regulations under section 6011 and is, therefore, subject to a penalty under section 6707A. After weighing litigating hazards and other costs of litigation, the IRS Office of Appeals agreed to settle X's deficiency for \$20,000. For purposes of calculating the amount of the penalty under paragraph (d)(1) of this section, the settlement does not affect the decrease in tax shown on X's return as a result of the listed transaction which remains \$40,000. The amount of X's penalty under section 6707A is \$30,000, which amount is 75 percent of the \$40,000 decrease in tax.

(iii) *Example 3.* For the 2018 tax year, Taxpayer X, a natural person, failed to disclose participation in a reportable transaction that is not a listed transaction and, therefore, is subject to a penalty under section 6707A. After offsetting gross income with the losses generated in the reportable transaction, X's return reported adjusted gross income of \$100,000. The return also reported \$12,000 of medical expenses, \$4,500 of which were deductible after applying the 7.5 percent floor in section 213(a) and (f). If X's return had not reflected participation in the reportable transaction, X's adjusted gross income would have been \$140,000 and the deductible medical expenses would be limited to \$1,500 (\$3,000 less than the deductible amount claimed). Under paragraph (d)(1) of this section, the decrease in tax shown on X's return as a result of X's participation in the reportable transaction takes into account both the tax on the additional \$40,000 in adjusted gross income had X not participated in the reportable transaction and the tax on the \$3,000 adjustment to X's deductible medical expenses caused by the increase in adjusted gross income.

(iv) *Example 4.* Taxpayer X, a natural person, timely filed X's 2019 return and reported income tax of \$40,000. X did not participate in a reportable transaction in 2019. X participated in a listed transaction in 2020, but failed to file a complete and proper disclosure statement with X's 2020 return as required by the regulations under section 6011. As filed, the 2020 return reports that X owes no tax and has a loss of \$10,000. If the tax consequences of the listed transaction were not reflected on the 2020 return, the return would show income tax of \$15,000 and no loss. X files an amended return for the 2019 tax year on which the only amendment is to carry back the \$10,000 loss reported on the 2020 tax return to the 2019 tax year. The loss carryback reduces X's tax liability for 2019 by \$3,000 to \$37,000. X fails to file a complete and proper disclosure statement with the 2019 amended return as required by the regulations under section 6011. Two penalties under sec-

tion 6707A apply: one for X's failure to disclose participation in a listed transaction reflected on the 2020 return and another for the failure to disclose participation in the same listed transaction reflected on the 2019 amended return. Under paragraph (d)(1) of this section, the decrease in tax on the 2020 return resulting from the listed transaction is \$15,000, which is the excess of the amount of tax that would have been shown on X's 2020 return if that return did not reflect X's participation in the listed transaction over the tax X actually reported on the 2020 return. The amount of the section 6707A penalty with respect to the 2020 return is \$11,250, which amount is 75 percent of the decrease in tax. Under paragraph (d)(1) of this section, the decrease in tax on the 2019 amended return that results from the listed transaction is \$3,000. This amount is computed by determining the excess of the amount of tax that would have been shown on X's 2019 amended return if that return did not reflect X's participation in the listed transaction over the tax X actually reported on the 2019 amended return reflecting the loss carryback resulting from X's participation in the listed transaction in 2020. See paragraph (c) of this section. However, because X is a natural person, and because 75 percent of the \$3,000 decrease in tax is less than \$5,000, which is the minimum penalty under paragraph (a) of this section and section 6707A(b)(3), the section 6707A penalty with respect to the failure to disclose the listed transaction with respect to the 2019 amended return is \$5,000. Accordingly, X is subject to a \$11,250 section 6707A penalty for failure to disclose participation in a listed transaction reflected on the 2020 return and a \$5,000 section 6707A penalty for failure to disclose participation in a listed transaction reflected on the 2019 amended return.

(v) *Example 5.* Taxpayer X, a corporation, timely files its 2019, 2020, and 2021 returns, each of which reflects participation in the same transaction. In 2023, the transaction becomes a listed transaction. When the transaction at issue became listed, the periods of limitations on assessment on X's 2020 and 2021 tax year were open, but the period of limitations on assessment on X's 2019 tax year was closed. Pursuant to §1.6011-4(a) and (e)(2)(i) of this chapter, X is required to file a single disclosure statement reflecting its participation in the listed transaction 90 calendar days after the date on which the transaction becomes a listed transaction. X failed to file a disclosure statement as required. Pursuant to paragraph (d)(1)(ii) of this section, the section 6707A penalty is computed by aggregating the decrease in tax shown on the 2020 return and the decrease in tax shown on the 2021 return. Because the period of limitations on assessment for X's 2019 tax year was closed at the time the transaction became listed, the decrease in tax shown on the 2019 return as a result of X's participation in the listed transaction is not taken into account in computing the amount of the penalty. The decreases in tax shown on the returns as a result of X's participation in the transaction are \$265,000 in tax year 2020 and \$7,000 in tax year 2021. Under paragraph (d)(1) of this section, the total decrease in tax shown is computed by adding the decrease in tax for 2020 and the decrease in tax for 2021, which is \$272,000. Seventy-five percent of that amount is \$204,000. Because X is a corporation, the maximum penalty amount is \$200,000 under paragraph

(a) of this section and section 6707A(b)(2)(A). Accordingly, X is subject to a section 6707A penalty of \$200,000, rather than \$204,000.

(vi) *Example 6.* Taxpayer X, a natural person, files X's 2019 return reflecting participation in a reportable transaction that is not a listed transaction, but fails to disclose the transaction as required by the regulations under section 6011. The decrease in tax with respect to X's 2019 return as a result of participation in the reportable transaction is \$20,000. X files an amended 2019 return to include a net operating loss carried forward from a prior year, which X inadvertently failed to include when filing the original 2019 return. The amended return reflects participation in the same reportable transaction, but X again fails to disclose the transaction as required by the regulations under section 6011. The decrease in tax with respect to the amended 2019 return as a result of participation in the transaction is also \$20,000. X is subject to two separate 6707A penalties: one for the failure to disclose the reportable transaction with respect to the tax benefits from the reportable transaction reflected on the original 2019 return and one for the failure to disclose the reportable transaction with respect to the tax benefits from the reportable transaction reflected on the amended 2019 return. Seventy-five percent of the \$20,000 decrease in tax shown on the original 2019 return is \$15,000 and on the amended 2019 return is another \$15,000. However, because X is a natural person, the amount of the penalty for failure to disclose is limited to the maximum amount of \$10,000 under §301.6707A-1(a) and section 6707A(b)(2)(B). Accordingly, the amount of the section 6707A penalty for the 2019 original return is \$10,000 and the amount of the section 6707A penalty for the 2019 amended return is also \$10,000, for a total penalty of \$20,000.

(vii) *Example 7.* Taxpayer X, a natural person, timely files X's 2019 return on April 15, 2020, reflecting participation in a transaction that was not identified as a reportable transaction when X filed the return, the only year X participated in the transaction. In early 2021, the IRS identifies the transaction as a listed transaction. X fails to disclose the listed transaction as required by the regulations under section 6011. In late 2021, X files an amended 2019 income tax return to claim deductions that had been omitted from the originally filed 2019 return. The amended 2019 return reflects X's participation in the listed transaction. X does not disclose the listed transaction when filing the amended 2019 return. The decrease in tax resulting from X's participation in the transaction is \$100,000 with respect to the original 2019 return and \$80,000 with respect to the 2019 amended return. Pursuant to §1.6011-4(e)(2)(i) of this chapter, X was required to file a disclosure statement reflecting X's participation in the listed transaction if the period of limitations on assessment of tax remained open for any taxable year in which the taxpayer participated in the listed transaction. When the transaction at issue became listed, the period of limitations on assessment on X's 2019 tax year was open. Pursuant to §1.6011-4(e)(1) of this chapter, X was also required to disclose participation in the transaction when the 2019 amended return was filed because the transaction was a listed transaction at that time. X is subject to two penalties under section 6707A: one for the



failure to disclose participation in a listed transaction reflected on X's original 2019 return within 90 calendar days of the date the transaction became a listed transaction as required by §1.6011-4(e)(2)(i) of this chapter and another for the failure to disclose participation in the same listed transaction reflected on the 2019 amended return. Seventy-five percent of this decrease in tax with respect to the original 2019 return is \$75,000 (75 percent of \$100,000) and with respect to the 2019 amended return is \$60,000 (75 percent of \$80,000). Pursuant to paragraph (d)(1)(iv) of this section, because X is subject to two separate penalties, the maximum penalty amount of \$100,000 under §301.6707A-1(a) and section 6707A(b)(2)(A) applies separately to each penalty and does not operate to reduce the amount of the X's 6707A penalties.

(viii) *Example 8.* Under §1.6011-4 of this chapter, Partnership M is required to attach a disclosure statement to its Form 1065, U.S. Return of Partnership Income, for the 2020 taxable year. M fails to do so and is, therefore, subject to a penalty under section 6707A. No tax is required to be shown on M's Form 1065. Pursuant to §301.6707A-1(d)(2), M is subject to the minimum section 6707A penalty of \$10,000. The partners of Partnership M may have separate disclosure obligations as required by the regulations under section 6011 and would be subject to separate section 6707A penalties if they fail to comply with the disclosure requirements.

(ix) *Example 9.* In tax year 2019, Taxpayer X participated in a listed transaction that resulted in a \$150,000 deduction. X's gross income for 2019 before the listed transaction deduction is \$100,000. X uses \$100,000 of the deduction resulting in zero tax liability for 2019. X carried over to tax year 2020 the remaining \$50,000 net operating loss that was not used in 2019. X's gross income for tax year 2020 is \$200,000 but as a result of the \$50,000 net operating loss carryover, X reports \$150,000 adjusted gross income. Pursuant to §1.6011-4 of this chapter, X is required to disclose participation in the listed transaction for both 2019 and 2020, but X fails to make the required disclosures and is therefore subject to the section 6707A penalty for each failure. The decrease in tax on the 2019 return is the amount of tax on \$100,000 because that is the difference between the amount of tax that would have been shown on the return if it did not reflect participation in the listed transaction and the tax actually reported. No other tax resulted from X's participation in the listed transaction. The amount of the penalty with respect to X's failure to disclose with respect to 2019 will be 75 percent of the decrease in tax. The decrease in tax

on the 2020 return is the difference between the tax shown on the return as filed and the tax that would be shown if the \$50,000 net operating loss was not used, including any changes to the amount of tax that are only indirectly connected with the listed transaction. The amount of the penalty with respect to X's failure to disclose with respect to 2020 will be 75 percent of the decrease in tax, subject to the minimum and maximum penalty amount limitations.

(x) *Example 10.* In tax year 2020, Taxpayer X, a natural person, participated in a listed transaction that resulted in a \$50,000 deduction. X also has a net operating loss carryover of \$150,000 from 2019. X uses the deduction of \$50,000 and a portion of the net operating loss carryover resulting in zero tax liability for 2020. X carries over the remaining net operating loss to tax year 2021. X's gross income for 2021 is \$250,000, but as a result of the net operating loss carryover, X reports reduced adjusted gross income of \$150,000. Pursuant to §1.6011-4 of this chapter, X is required to disclose participation in the listed transaction for both 2020 and 2021, but X fails to make the required disclosures and is subject to the section 6707A penalty for each failure. The decrease in tax on the 2020 return that results from the reportable transaction is zero. Because X has \$150,000 of a net operating loss carryover not attributable to the reportable transaction, X's tax without the benefits of the reportable transaction is the same as the tax shown on the 2020 return as filed. Because X is a natural person, the minimum penalty of \$5,000 under §301.6707A-1(a) and section 6707A(b)(3) will apply for the failure to disclose the listed transaction with the 2020 return. The decrease in tax on the 2021 return is the difference between the tax shown on the return as filed and the tax that would be shown if X had only \$50,000 of net operating loss to carry over to 2021 (i.e., if X had not offset \$50,000 of its 2020 gross income with the deduction resulting from the reportable transaction and thus had used \$100,000 of its net operating loss carryover in 2020), including any changes to the amount of tax that are only indirectly connected with the listed transaction. The amount of the penalty with respect to the disclosure relating to 2021 will be 75 percent of this decrease in tax, subject to the minimum and maximum penalty amount limitations.

(xi) *Example 11.* Taxpayer X, a public corporation required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, timely filed its 2019 return reflecting tax benefits from a reportable transaction that is not a listed transaction and properly disclosed the transaction in accordance with the regulations under section

6011. In 2023, as a result of an examination of X's 2019 return, the IRS imposes a penalty under section 6662A with respect to the reportable transaction. The decrease in tax for purposes of paragraph (d)(1) of this section is \$190,000. As a person who is required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, X is required, pursuant to section 6707A(e), to disclose the penalty imposed under section 6662A to the Securities and Exchange Commission in 2023, which X failed to do. X's failure to disclose the section 6662A penalty is treated as a failure to disclose to which section 6707A(b) applies. Thus, X is subject to a penalty under section 6707A(e), which equals 75 percent of the decrease in tax resulting from the transaction. The decrease in tax resulting from the reportable transaction was \$190,000, 75 percent of which is \$142,500. Because X is a corporation and the transaction is not a listed transaction, the amount of the penalty is limited to \$50,000 under paragraph (a) of this section and section 6707A(b)(2)(B). Therefore, rather than \$142,500, X is subject to a \$50,000 section 6707A penalty for failure to disclose the section 6662A penalty to the SEC.

\* \* \* \* \*

(g) *Applicability date.* (1) This section applies to penalties assessed after March 26, 2019.

(2) For penalties assessed before March 26, 2019, §301.6707A-1 (as contained in 26 CFR part 1, revised April 2018) shall apply.

Kirsten Wielobob

*Deputy Commissioner for Services  
and Enforcement.*

Approved: November 16, 2018.

David J. Kautter,

*Assistant Secretary of the Treasury  
(Tax Policy).*

(Filed by the Office of the Federal Register on March 25, 2019, 8:45 a.m., and published in the issue of the Federal Register for March 26, 2019, 84 F.R. 11217)



## Part IV.

### Notice of Proposed Rulemaking

### Updating Section 301 Regulations To Reflect Statutory Changes

#### REG-121694-16

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 301 of the Internal Revenue Code of 1986 (Code). The proposed regulations would update existing regulations under section 301 to reflect statutory changes made by the Technical and Miscellaneous Revenue Act of 1988, which changes provide that the amount of a distribution of property made by a corporation to its shareholder is the fair market value of the distributed property. The proposed regulations would affect any shareholder who receives a distribution of property from a corporation.

DATES: Written or electronic comments and requests for a public hearing must be received by June 24, 2019.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-121694-16), 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-121694-16), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-121694-16).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Grid R. Glycer, (202) 317-6847; concerning submission of comments, Regina Johnson, (202) 317-6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 301 of the Code originally was enacted as part of the Internal Revenue Code of 1954. Section 301 provides rules for the treatment of a distribution of property, including money, made by a corporation to its shareholder with respect to that shareholder's stock ownership in that corporation (distribution).

Section 301(b)(1) provides general rules for determining the amount of a distribution. As enacted in 1954, section 301(b)(1) provided rules for determining the amount of a distribution that differed depending on whether the shareholder receiving the distribution (distributee) was a corporation. Pre-1986 amendments to section 301(b)(1) added special rules to determine the amount of distributions received from foreign distributing corporations and by foreign corporate distributees. Similarly, section 301(d), as enacted in 1954, provided rules for determining the basis of property received in a distribution that differed depending on whether the distributee was a corporation. As with section 301(b)(1), pre-1986 amendments to section 301(d) added special rules to determine the basis of property received from foreign distributing corporations and by foreign corporate distributees.

Section 1006(e)(10) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (1988) (the Act), amended section 301(b)(1) to eliminate the distinction between corporate and noncorporate distributees as well as the special rules relating to foreign corporations. Similarly, section 1006(e)(11) of the Act amended section 301(d) to eliminate the distinction between corporate and noncorporate distributees. (These amendments to section 301(b)(1) and (d) are referred to as the 1988 Amendments.) Section 1019(a) of the Act provided that, in general, the 1988 Amendments were effective as if included in the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

As a result of the 1988 Amendments, effective for taxable years beginning af-

ter December 31, 1986, section 301(b)(1) provides that, for purposes of section 301, the amount of any distribution shall be the amount of money received plus the fair market value of the other property received. Section 301(d), as amended by the 1988 Amendments and effective for taxable years beginning after December 31, 1986, provides that the basis of property received in a distribution to which section 301(a) applies shall be the fair market value of such property.

The current regulations issued under section 301 reflect the rules of sections 301(b)(1) and 301(d) as they existed prior to the 1988 Amendments. Accordingly, to the extent preempted by statute, the current regulations have no application.

##### Explanation of Provisions.

The proposed regulations update §1.301-1 to reflect the statutory changes made to section 301(b)(1) and (d) by the 1988 Amendments. The scope of the changes to the current regulations issued under section 301 made by these proposed regulations is limited to (1) deleting regulatory provisions made obsolete by statutory changes, (2) making minor additions and revisions to regulatory provisions to reflect current statutory text, and (3) making certain non-substantive changes for purposes of clarity and readability, including reordering and redesignating paragraphs of the current regulations. The proposed regulations also update cross-references in §§1.356-1(f), 1.368-2(m)(3)(iii), 1.902-1(a)(12), and 1.902-3(a)(7) to reflect the proposed reordering and redesignating of paragraphs in §1.301-1.

Specifically, some of the provisions of current §1.301-1(b) are now found in proposed §1.301-1(c). Thus, the definition of the amount of a distribution subject to section 301 and the determination of the fair market value of a distribution remain in §1.301-1(b), while the determination of when to include a distribution in gross income, and its fair market value, is now found in proposed §1.301-1(c).

In addition, current §1.301-1(g) is redesignated as proposed §1.301-1(f) and is revised to clarify the application

of the principles of section 357(d) to the limitation on the amount of a distribution provided by section 301(b)(2). Section 357(d) was added to the Code by section 3001(b)(1) of the Miscellaneous Trade and Technical Corrections Act of 1999, Pub.L. No. 106-36, 113 Stat. 127. On January 4, 2001, the Treasury Department and the IRS published a temporary

regulation (T.D. 8924) in the **Federal Register** (66 FR 723) to address this interaction. Current §1.301-1(g), published in the **Federal Register** (66 FR 49278) on September 27, 2001 as T.D. 8964, provides that no reduction shall be made for the amount of any liability, unless the liability is assumed by the shareholder within the meaning of section 357(d).

Proposed §1.301-1(f) would clarify the language of current §1.301-1(g) by providing that no reduction in the amount of a distribution is made for the amount of any liability except to the extent the liability is assumed by the shareholder within the meaning of section 357(d).

The specific changes to §1.301-1 are shown in the following table:

<i>Paragraph Designation in §1.301-1</i>	<i>Change</i>
(a)	Updated to reflect current law
(b)	Updated to reflect current law, with the definition of the amount of a distribution subject to section 301 and the determination of the fair market value of a distribution remaining in paragraph (b) and the determination of when to include a distribution in gross income, and its fair market value, redesignated as paragraph (c)
(c)	Redesignated as paragraph (d)
(d)	Deleted as obsolete
(e)	Deleted as obsolete
(f)	Updated to reflect current law and redesignated as paragraph (e)
(g)	Redesignated as paragraph (f) and revised to clarify that no reduction in the amount of a distribution is made for the amount of any liability except to the extent the liability is assumed by the shareholder within the meaning of section 357(d).
(h)	Updated to reflect current law and redesignated as paragraph (g)
(i)	No change
(j)	Updated to reflect current law and redesignated as paragraph (h)
(k)	Deleted as obsolete
(l)	Redesignated as paragraph (j)
(m)	Redesignated as paragraph (k)
(n)	Deleted as obsolete
(o)	Deleted as obsolete
(p)	Redesignated as paragraph (l)
(q)	Redesignated as paragraph (m)
(n)	New effective date paragraph

#### **Proposed Effective/Applicability Date**

The proposed regulations would apply to distributions made after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. However, these proposed regulations would update current regulations under section 301 to reflect statutory changes made by the 1988 Amendments, which statutory changes apply to distributions made in taxable years beginning after December 31, 1986.

#### **Special Analyses**

This regulation is not subject to review under section 6(b) of Executive Order 12866

pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Because these 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), 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 Public Hearing**

Before these proposed regulations are adopted as final regulations, consid-

eration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

#### **Drafting Information**

The principal author of these regulations is Grid R. Glycer of the Office of As-

sociate Chief Counsel (Corporate). Other personnel from the Treasury Department and the IRS participated in developing these regulations.

\* \* \* \* \*

## **Proposed Amendments to the Regulations**

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

### **PART 1--INCOME TAX REGULATIONS**

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

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

Par. 2. Section 1.301-1 is revised to read as follows:

#### *§1.301-1 Rules applicable with respect to distributions of money and other property.*

(a) *General.* Section 301 provides the general rule for treatment of distributions made in taxable years beginning after December 31, 1986, of property by a corporation to a shareholder with respect to its stock. The term *property* is defined in section 317(a). Such distributions, except as otherwise provided in this chapter, shall be treated as provided in section 301(c). Under section 301(c), distributions may be included in gross income to the extent the amount distributed is considered a dividend under section 316, applied against and reduce the adjusted basis of the stock, treated as gain from the sale or exchange of property, or (in the case of certain distributions out of increase in value accrued before March 1, 1913) may be exempt from tax. The amount of the distributions to which section 301 applies is determined in accordance with the provisions of section 301(b). The basis of property received in a distribution to which section 301 applies is determined in accordance with the provisions of section 301(d).

(b) *Amount of distribution and determination of fair market value.* The amount of a distribution to which section 301 applies shall be the amount of money received in the distribution, plus the fair market value of other property received in the distribution. The fair market value of any property distributed shall be determined as of the date of the distribution.

(c) *Time of inclusion in gross income and time of determination of fair market value.* A distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands without regard to whether such date is the same as that on which the corporation made the distribution. For example, if a corporation distributes a taxable dividend in property on December 30, 2018, which is received by, or unqualifiedly made subject to the demand of, its shareholders on January 3, 2019, the amount to be included in the gross income of the shareholders will be the fair market value of such property on December 30, 2018, although such amount will not be includible in the gross income of the shareholders until January 3, 2019.

(d) *Application of section to shareholders.* Section 301 is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in the shareholder's capacity as such.

(e) *Example.* Corporation M, formed in 1998, has never been an acquiring corporation in a transaction to which section 381(a) applies. On January 1, 2019, A, an individual owned all of the stock of Corporation M, consisting of a single share, with an adjusted basis of \$2,000. During 2019, A received distributions from Corporation M totaling \$30,000, consisting of \$10,000 in cash and listed securities having a basis in the hands of Corporation M and a fair market value on the date distributed of \$20,000. Corporation M's taxable year is the calendar year. As of December 31, 2018, Corporation M had accumulated earnings and profits in the amount of \$26,000, and it had no earnings and profits and no deficit for 2019. Of the \$30,000 received by A, \$26,000 will be treated as an ordinary dividend; the remaining \$4,000 will be applied against the adjusted basis of his stock; the \$2,000 in excess of the adjusted basis of his stock will be treated as gain from the sale or exchange of property under section 301(c)(3)(A). If A subsequently sells his stock in Corporation M, the basis for determining gain or loss on the sale will be zero.

(f) *Reduction for liabilities--(1) General rule.* For purposes of section 301(b)(2),

no reduction in the amount of a distribution shall be made for the amount of any liability, except to the extent the liability is assumed by the shareholder within the meaning of section 357(d).

(2) *No reduction below zero.* Any reduction pursuant to paragraph (f)(1) of this section shall not cause the amount of the distribution to be reduced below zero.

(3) *Effective dates--(i) In general.* This paragraph (f) applies to distributions occurring after January 4, 2001.

(ii) *Retroactive application.* This paragraph (f) also applies to distributions made on or before January 4, 2001, if the distribution is made as part of a transaction described in, or substantially similar to the transaction in, Notice 99-59 (1999-2 C.B. 761), including transactions designed to reduce gain (see §601.601(d)(2) of this chapter). For rules for distributions on or before January 4, 2001 (other than distributions on or before that date to which this paragraph (f) applies), see rules in effect on January 4, 2001 (see §1.301-1(g) as contained in 26 CFR part 1 revised April 1, 2001).

(g) *Basis.* The basis of property received in a distribution to which section 301 applies shall be the fair market value of such property. See paragraph (b) of this section.

(h) *Transfers for less than fair market value.* If property is transferred by a corporation to a shareholder for an amount less than its fair market value in a sale or exchange, such shareholder shall be treated as having received a distribution to which section 301 applies. In such case, the amount of the distribution shall be the excess of the fair market value of the property over the amount paid for such property at the time of the transfer. For example, on January 3, 2019, A, a shareholder of Corporation X, purchased property from X for \$20. The fair market value of such property on January 3, 2019 was \$100. The amount of the distribution to A determined under section 301(b) is \$80.

(i) [Reserved]

(j) *Transactions treated as distributions.* A distribution to shareholders with respect to their stock is within the terms of section 301 although it takes place at the same time as another transaction if the distribution is in substance a separate transaction whether or not connected in a



formal sense. This is most likely to occur in the case of a recapitalization, a reincorporation, or a merger of a corporation with a newly organized corporation having substantially no property. For example, if a corporation having only common stock outstanding, exchanges one share of newly issued common stock and one bond in the principal amount of \$10 for each share of outstanding common stock, the distribution of the bonds will be a distribution of property (to the extent of their fair market value) to which section 301 applies, even though the exchange of common stock for common stock may be pursuant to a plan of reorganization under the terms of section 368(a)(1)(E) (recapitalization) and even though the exchange of common stock for common stock may be tax free by virtue of section 354.

(k) *Cancellation of indebtedness.* The cancellation of indebtedness of a shareholder by a corporation shall be treated as a distribution of property.

(l) *Cross references.* For certain rules relating to adjustments to earnings and profits and for determining the extent to which a distribution is a dividend, see sections 312 and 316 and regulations thereunder.

(m) *Split-dollar and other life insurance arrangements--*(1) *Split-dollar life insurance arrangements--*(i) *Distribution of economic benefits.* The provision by a corporation to its shareholder pursuant to a split-dollar life insurance arrangement, as defined in §1.61-22(b)(1) or (2), of economic benefits described in §1.61-22(d) or of amounts described in §1.61-22(e) is treated as a distribution of property, the amount of which is determined under §1.61-22(d) and (e), respectively.

(ii) *Distribution of entire contract or undivided interest therein.* A transfer (within the meaning of §1.61-22(c)(3)) of the ownership of a life insurance contract (or an undivided interest therein) that is part of a split-dollar life insurance arrangement is a distribution of property, the amount of which is determined pursuant to §1.61-22(g)(1) and (2).

(2) *Other life insurance arrangements.* A payment by a corporation on behalf of a shareholder of premiums on a life insurance contract or an undivided interest therein that is owned by the shareholder constitutes a distribution of property, even

if such payment is not part of a split-dollar life insurance arrangement under §1.61-22(b).

(3) *When distribution is made--*(i) *In general.* Except as provided in paragraph (m)(3)(ii) of this section, paragraph (c) of this section shall apply to determine when a distribution described in paragraph (m)(1) or (2) of this section is taken into account by a shareholder.

(ii) *Exception.* Notwithstanding paragraph (c) of this section, a distribution described in paragraph (m)(1)(ii) of this section shall be treated as made by a corporation to its shareholder at the time that the life insurance contract, or an undivided interest therein, is transferred (within the meaning of §1.61-22(c)(3)) to the shareholder.

(4) *Effective date--*(i) *General rule.* This paragraph (m) applies to split-dollar and other life insurance arrangements entered into after September 17, 2003. For purposes of this paragraph (m)(4), a split-dollar life insurance arrangement is entered into as determined under §1.61-22(j)(1)(ii).

(ii) *Modified arrangements treated as new arrangements.* If a split-dollar life insurance arrangement entered into on or before September 17, 2003 is materially modified (within the meaning of §1.61-22(j)(2)) after September 17, 2003, the arrangement is treated as a new arrangement entered into on the date of the modification.

(n) *Applicability date.* Paragraphs (a) through (c), (e), (g), and (h) of this section apply to distributions under section 301 made after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Par. 3. Section 1.356-1 is amended by revising paragraph (f) to read as follows:

*§1.356-1 Receipt of additional consideration in connection with an exchange.*

\*\*\*\*\*

(f) See §1.301-1(j) for certain transactions which are not within the scope of section 356.

\*\*\*\*\*

Par. 4. Section 1.368-2 is amended by revising the last sentence of paragraph (m)(3)(iii) to read as follows:

*§1.368-2 Definition of terms.*

\*\*\*\*\*

(m) \*\*\*\*\*

(3) \*\*\*\*\*

(iii) \*\*\*\*\* See §1.301-1(j).

\*\*\*\*\*

#### **§ 1.902-1(a)(12) [Amended]**

Par.5. In § 1.902-1(a)(12), remove the reference “§1.301-1(b)” and add in its place “§1.301-1(c)”.

#### **§ 1.902-3(a)(7) [Amended]**

Par.6. In § 1.902-3(a)(7), remove the reference “§1.301-1(b)” and add in its place “§1.301-1(c)”.

Kirsten Wielobob  
Deputy Commissioner for Services  
and Enforcement.

(Filed by the Office of the Federal Register on March 25, 2019, 8:45 a.m., and published in the issue of the Federal Register for March 26, 2019, 84 F.R. 11263)

## **Notice of Proposed Rulemaking**

### **Partnership Transactions Involving Equity Interests of a Partner**

**REG-135671-17**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations to amend final regulations that prevent a corporate partner from avoiding corporate-level gain through transactions with a partnership involving equity interests of the partner or certain related entities. These regulations affect partnerships and their partners.

DATES: Comments and requests for a public hearing must be received by June 24, 2019.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-135671-17), Room 5203, Internal Revenue Service, P.O. 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-135671-17), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-135671-17).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Kevin I. Babitz, (202) 317-6852, or Mary Brewer, (202) 317-6975; concerning submission of comments or to request a public hearing, Regina L. Johnson at (202) 317-6901.

#### SUPPLEMENTARY INFORMATION:

##### **Background and Explanation of Provisions**

This notice of proposed rulemaking contains amendments to the Income Tax Regulations (26 CFR part 1) under section 337(d) of the Internal Revenue Code (Code) set forth in § 1.337(d)-3 (final regulations) that prevent a corporate partner from using a partnership to avoid recognition of corporate-level gain. The final regulations largely adopted proposed regulations (REG-149518-03) published in the **Federal Register** (80 FR 33451) on June 12, 2015 (2015 regulations) with minor, nonsubstantive clarifying changes in response to requests for further certainty in the single comment letter received on the proposed regulations. See the Explanation of Provisions section of the preamble to TD 9833 (83 FR 26580 (June 8, 2018)) for a detailed discussion of each of the specific points raised in the comment letter received on the 2015 regulations.

The rules set forth in this notice of proposed rulemaking contain substantive modifications to the final regulations relating to the definition of Stock of the Corporate Partner. Accordingly, the Treasury Department and the IRS determined it appropriate to publish these modifications in

the form of new proposed regulations to afford the public the opportunity to submit additional comments.

##### *1. Stock of the Corporate Partner: Attribution*

The final regulations apply to certain partnerships that hold stock of a Corporate Partner. For this purpose, a *Corporate Partner* is defined as a person that holds or acquires an interest in a partnership and that is classified as a corporation for federal income tax purposes. The final regulations define *Stock of the Corporate Partner* expansively to include stock and other equity interests, including warrants, other options, and similar interests, either in the Corporate Partner or in a corporation (referred to in this Background and Explanation of Provisions section as a Controlling Corporation) that controls the Corporate Partner within the meaning of section 304(c), except that section 318(a) (1) and (3) would not apply. Stock of the Corporate Partner also includes an interest in any entity to the extent that the value of the interest is attributable to Stock of the Corporate Partner.

The final regulations adopted a definition of Stock of the Corporate Partner that was modified as compared to the definition in the regulations that the Treasury Department and the IRS proposed on December 15, 1992 (PS-91-90, REG-208989-90, 1993-1 CB 919) (1992 proposed regulations). The final regulations broadened the definition of Stock of the Corporate Partner with respect to the relationship needed for a Controlling Corporation to be treated as controlling the Corporate Partner (using a modified section 304(c) standard instead of section 1504(a)) but also narrowed the definition, generally excluding sister corporations and subsidiary corporations of the Corporate Partner from being treated as Controlling Corporations.

More specifically, the final regulations define Stock of a Corporate Partner by including stock and other equity interests of any corporation that controls the Corporate Partner within the meaning of section 304(c), except that section 318(a)(1) and (3) shall not apply (section 304(c) control). In contrast, the 1992 proposed regulation's definition was limited to stock or other equity interests issued by the Cor-

porate Partner and its "section 337(d) affiliates" – that is any corporation that is a member of an affiliated group as defined in section 1504(a) of the Code without regard to section 1504(b).

Section 304(c) control generally exists when there is ownership of stock of a corporation possessing at least 50 percent of the total combined voting power of all classes of the corporation's stock entitled to vote or at least 50 percent of the value of the shares of all classes of stock of the corporation, while control of a corporation under section 1504(a)(2) requires ownership of stock of the corporation possessing at least 80 percent of the total voting power of the stock of the corporation and at least 80 percent of the total value of the stock of the corporation. The Treasury Department and the IRS adopted this lower ownership threshold for determining control in the final regulations as a more appropriate standard for this purpose because General Utilities repeal could more easily be avoided by acquiring stock of a corporation that owns less than 80 percent of the vote and value of the Corporate Partner's stock. See *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935).

While section 304(c) incorporates the constructive ownership rules of section 318(a) with some modifications, the 2015 regulations excluded the application of section 318(a)(1) and (3) from their definition of control.

The commenter that submitted the only comment on the 2015 regulations demonstrated that families could use the exclusion of section 318(a)(1) attribution from the determination of section 304(c) control to structure transactions using partnerships to eliminate gain on appreciated assets or contravene the purposes of section 337(d) in other ways. For example—

Husband owns 90 percent of corporation A, which owns 49 percent of Corporate Partner (CP). Wife owns 90 percent of corporation B, which also owns 49 percent of CP. CP owns an interest in partnership PRS. Under these facts, because the 2015 regulations determined section 304(c) control without applying the section 318(a)(1) family attribution rule, neither A nor B control CP. Accordingly, other partners in PRS could contribute stock of A and B to PRS in exchange for an interest in PRS without triggering gain to A or B.

The Treasury Department and the IRS agree with the commenter that excluding section 318(a)(1) attribution from the determination of section 304(c) control could produce unintended results. In addition, the Treasury Department and the IRS have determined that taxpayers can structure transactions to take advantage of the exclusion of section 318(a)(3) attribution from the determination of section 304(c) control. For example, in the preceding fact pattern, if the interests held by Husband and Wife were instead held by a single corporation, X, neither A nor B would control CP without the application of section 318(a)(3) attribution.

As a result, the Treasury Department and the IRS propose to modify the definition of Stock of the Corporate Partner to eliminate the exclusion of section 318(a)(1) and (3) attribution from the determination of section 304(c) control. However, as explained below, the Treasury Department and the IRS propose to limit this expanded definition of Stock of the Corporate Partner to entities that own a direct or indirect interest in the Corporate Partner.

The exclusion of attribution under sections 318(a)(1) and 318(a)(3) in the 2015 regulations and the final regulations was intended to limit section 304(c) control to entities that own a direct or indirect interest in the Corporate Partner, while excluding entities that do not own a direct or indirect interest in the Corporate Partner. To implement this intent more precisely, the Treasury Department and the IRS propose to limit the proposed scope of section 304(c) control to ownership, direct or indirect, of an interest in the Corporate Partner. For the purpose of testing direct or indirect ownership of an interest in the Corporate Partner, ownership of Stock of the Corporate Partner would be attributed to an entity under section 318(a)(2) (except that the 50-percent ownership limitation in section 318(a)(2)(C) would not apply) and under section 318(a)(4), but otherwise without regard to section 318. Thus, sections 318(a)(1), 318(a)(3), and 318(a)(5) would not apply for determining whether an entity directly or indirectly owns an interest in Stock of the Corporate Partner, but once an entity is found to directly or indirectly own an interest in such stock, then the section 304(c) control definition would apply in its entirety to determine

whether the tested entity is a Controlling Corporation. The Treasury Department and the IRS continue to study the appropriate scope of the definition of Stock of the Corporate Partner, and request comments regarding these provisions.

## *2. Definition of Stock of the Corporate Partner: Affiliated Groups*

These proposed regulations, if finalized, would make a second change to the definition of Stock of the Corporate Partner. The final regulations provide that the term Stock of the Corporate Partner does not include any stock or other equity interests held or acquired by a partnership if all interests in the partnership's capital and profits are held by members of an affiliated group as defined in section 1504(a) that includes the Corporate Partner (Affiliated Group Exception). The 1992 proposed regulations included affiliate stock within its definition of the Stock of a Corporate Partner, but the 2015 proposed regulations instead set forth this Affiliated Group Exception, which the final regulations adopted. Thus, the final regulations do not apply if a domestic corporation and its wholly owned domestic subsidiaries (each of which is an includible corporation under section 1504(b)) are the only partners in a partnership and any of these corporations contributes stock of another affiliate to a partnership. The preamble to T.D. 9722 (80 FR 33402 (June 12, 2015)), which contained temporary regulations that accompanied the 2015 regulations, stated that the Treasury Department and the IRS had determined that the Affiliated Group Exception is appropriate because "the purpose of these regulations is not implicated if a partnership is owned entirely by affiliated corporations."

After further study, the Treasury Department and the IRS have determined that the Affiliated Group Exception may result in abuse and therefore is not appropriate. Specifically, the Treasury Department and the IRS believe that a partnership held entirely by members of an affiliated group could enter into transactions that permanently eliminate the built-in gain on an appreciated asset that one partner contributes to the partnership. For example—

Assume that P, a corporation, owns all of the stock of S1, and S1 owns all of the stock of CP. P, S1, and CP are members of

an affiliated group. P and CP form a 50-50 partnership; CP contributes an appreciated asset to the partnership; and P contributes S1 stock with basis equal to fair market value. After seven years, the partnership liquidates and distributes the S1 stock to CP and the appreciated asset to P. At that time, the asset may be sold outside of the group with an artificially increased basis. The built-in gain that was in the asset is now preserved in the S1 stock held by CP. The group may permanently eliminate the gain without tax by liquidating CP under section 332. CP would receive nonrecognition treatment on distribution of the S1 stock to S1 under section 332, and S1 would receive nonrecognition treatment on the receipt of its own stock under section 1032. Thus, the liquidation of CP permanently eliminates the built-in gain on the appreciated asset that attached to the stock CP held in S1 after the liquidation of the partnership.

This ability to increase the basis of an appreciated asset artificially and to eliminate the built-in gain permanently contravenes the purposes of section 337(d) and these regulations. The Treasury Department and the IRS are also aware that practitioners have observed that the Affiliated Group Exception runs counter to the general rule that related-party transactions are subject to greater scrutiny. In light of these concerns, these proposed regulations would remove the Affiliated Group Exception contained in the final regulations.

However, because there may be specific circumstances under which the elimination of the Affiliated Group Exception could adversely impact ordinary business transactions between affiliated group members and group-owned partnerships, the Treasury Department and the IRS request comments describing situations in which a more tailored version of the Affiliated Group Exception would be warranted.

## *3. Definition of Stock of the Corporate Partner: Value of an interest attributable to Stock of the Corporate Partner*

These proposed regulations would modify the scope of the rule in the final regulations that Stock of the Corporate Partner includes interests in any entity to the extent that the value of the interest is attributable to Stock of the Corporate



Partner (Value Rule). Under the final regulations, the Value Rule applies to all interests in an entity regardless of whether the entity is controlled by the Corporate Partner. The sole commenter responding to the 2015 regulations agreed that the scope of the Value Rule was appropriate if the entity was controlled by the Corporate Partner. However, for entities that are not controlled by the Corporate Partner, the commenter asked that the scope of the Value Rule be narrowed to apply only if 20 percent or more of the assets of an entity were Stock of the Corporate Partner.

The Treasury Department and the IRS agree that the Value Rule in the 2015 regulations and the final regulations could be overbroad in certain circumstances. For example—

Assume X, a publicly traded corporation, owns a portfolio investment in P, a publicly traded corporation. P controls CP, a Corporate Partner under the final regulations, within the meaning of section 304(c); thus, P's stock is Stock of the Corporate Partner under the final regulations. Under the Value Rule, X's stock would be Stock of the Corporate Partner to the extent that the value of X is attributable to Stock of the Corporate Partner. If CP contributed appreciated property to a partnership, and another party contributed X stock to the partnership, CP would be unable to determine whether it had engaged in a Section 337(d) Transaction (within the meaning of §1.337(d)-3(c)(3)) or otherwise apply the rules of the final regulations because CP (through P) might have no way to determine that the X stock used in the transaction could be Stock of the Corporate Partner. Alternatively, if CP were aware that X owned a portfolio investment in P, it would have no ability to determine the amount of X stock that is Stock of the Corporate Partner under the Value Rule. This is because, absent actual or constructive knowledge (for example through required disclosures such as filings with the Securities and Exchange Commission), a widely held corporation might not know or have the ability to know who owns its stock.

For this reason, the Treasury Department and the IRS have determined that narrowing the scope of the Value Rule is appropriate. However, the Treasury Department and the IRS decline to adopt

the commenter's specific suggestion that interests in an entity not be subject to the Value Rule unless 20 percent or more of the assets of the entity consisted of Stock of the Corporate Partner. Such a rule would cause the Value Rule to be overly narrow and could permit taxpayers to structure transactions that would contravene the purpose of section 337(d) and these regulations. Instead, the Treasury Department and the IRS propose to narrow the scope of the Value Rule through an alternate measure. Under the proposed regulations, if an entity is not controlled by the Corporate Partner and is not a Controlling Corporation, the Value Rule would apply to treat interests in the entity as Stock of the Corporate Partner only if the entity owns, directly or indirectly, 5 percent or more of the stock, by vote or value, of the Corporate Partner. For this purpose, direct or indirect ownership would mean ownership of stock that would be attributed to a person under section 318(a)(2) (except that the 50-percent ownership limitation in section 318(a)(2)(C) would not apply) and under section 318(a)(4), but otherwise without regard to section 318. The Treasury Department and the IRS believe that using a 5-percent ownership threshold is appropriate because entities have the ability to determine whether they have 5-percent or greater owners, and corporations may track their 5-percent shareholders for other reasons (such as for section 382 purposes). Further, the Treasury Department and the IRS propose to apply this 5-percent threshold to direct or indirect stock ownership, rather than all equity interests, in the Corporate Partner in order to make the Value Rule more readily administrable.

The proposed regulations also would clarify how taxpayers should apply the Value Rule to determine the extent to which the value of an equity interest is attributable to Stock of the Corporate Partner. The proposed regulations would provide that taxpayers would multiply the value of the equity interest in an entity by a ratio, the numerator of which is the fair market value of the Stock of the Corporate Partner owned directly or indirectly by the entity and the denominator of which is the fair market value of all of the equity interests in the entity. For this purpose, direct

or indirect ownership would mean ownership of stock that would be attributed to a person under section 318(a)(2) (except that the 50-percent ownership limitation in section 318(a)(2)(C) would not apply) and under section 318(a)(4), but otherwise without regard to section 318. The proposed regulations would also provide that the ratio may not exceed one. The Treasury Department and the IRS determined that the fair market value of all of the equity interests in the entity is the most appropriate measure to determine the value of the entity because the Value Rule seeks to determine what portion of the value of an equity interest in an entity reflects the value of Stock of the Corporate Partner owned by that entity.

Additionally, the proposed regulations would clarify that, if an equity interest is Stock of the Corporate Partner because it is an interest in the Corporate Partner or in an entity with a direct or indirect ownership interest that controls the Corporate Partner within the meaning of section 304(c), then the Value Rule will not apply. The Treasury Department and the IRS request comments on all aspects of the proposed changes to the scope of the Value Rule, including the appropriate measure of the value of the entity.

#### *4. Exception for Certain Dispositions of Stock*

Finally, these proposed regulations would make a modification to the exception for certain dispositions of stock in §1.337(d)-3(f)(2) to make its language consistent with the modified definition of Stock of the Corporate Partner. Under this exception, the final regulations do not apply to Stock of the Corporate Partner that (i) is disposed of (by sale or distribution) by the partnership before the due date (including extensions) of its federal income tax return for the taxable year of the relevant transaction; and (ii) is not distributed to the Corporate Partner or a corporation that controls the Corporate Partner. With respect to the second requirement, the final regulations refer to a corporation that controls the Corporate Partner within the meaning of section 304(c), except that section 318(a)(1) and (3) shall not apply. For the same reasons

that these proposed regulations modify the definition of Stock of the Corporate Partner, these proposed regulations also modify the second requirement of this exception to refer to a corporation that controls the Corporate Partner within the meaning of section 304(c), but only if the controlling corporation owns directly or indirectly stock or another equity interest in the Corporate Partner, in order to conform the second requirement with the modified definition of Stock of the Corporate Partner.

### Proposed Effective Date

These regulations are proposed to be effective as of the date of their publication as final regulations in the **Federal Register**. Taxpayers may rely on these proposed regulations for transactions occurring on or after June 12, 2015 and prior to the date that these regulations are published as final regulations in the **Federal Register**, provided that the taxpayer consistently applies all of the proposed regulations to such transactions.

### Special Analyses

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

These proposed regulations do not impose a collection of information on small entities. Further, pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these proposed regulations would primarily affect sophisticated ownership structures with interlocking ownership of corporations, partnerships and corporate stock. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have 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 these proposed regulations are adopted as final regulations, consideration will be given to comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at <http://www.regulations.gov> or upon request. A public hearing will 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 authors of these regulations are Kevin I. Babitz, Office of the Associate Chief Counsel (Passthroughs and Special Industries) and Mary Brewer, Office of the Associate Chief Counsel (Corporate). However, other personnel from the Treasury Department and the IRS participated in their development.

\* \* \* \* \*

### Proposed Amendments to the Regulations

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

#### PART I—INCOME TAXES

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

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

Par. 2. Section 1.337(d)-3 is amended by revising paragraphs (c)(2), (f)(2)(ii) and (i) to read as follows:

*§1.337(d)-3 Gain recognition upon certain partnership transactions involving a partner's stock.*

\* \* \* \* \*

(c) \* \* \*

(2) *Stock of the Corporate Partner*—(i) *In general.* With respect to a Corporate Partner, Stock of the Corporate Partner includes stock, warrants and other options to acquire stock, and similar inter-

ests (each an equity interest) in the Corporate Partner. Stock of the Corporate Partner also includes equity interests in a corporation that controls the Corporate Partner within the meaning of section 304(c), and which also has a direct or indirect equity interest in the Corporate Partner. Solely for purposes of determining whether a corporation that controls the Corporate Partner also has a direct or indirect equity interest in the Corporate Partner under this paragraph (c)(2), a direct or indirect ownership of an equity interest in the Corporate Partner includes ownership of Stock of the Corporate Partner that would be attributed to a person under section 318(a)(2) (except that the 50-percent ownership limitation in section 318(a)(2)(C) does not apply) and under section 318(a)(4) (but otherwise without regard to section 318).

(ii) *Equity Interests with value attributable to Stock of the Corporate Partner.* If an equity interest in an entity is not Stock of the Corporate Partner within the meaning of paragraph (c)(2)(i) of this section, then the equity interest will be treated as Stock of the Corporate Partner to the extent that the value of that equity interest is attributable to Stock of the Corporate Partner. The preceding sentence will apply only if either—

(A) The Corporate Partner is in control (within the meaning of section 304(c)) of that entity; or

(B) That entity owns directly or indirectly 5 percent or more, by vote or value, of the stock in the Corporate Partner.

(iii) *Determination of value attributable to Stock of the Corporate Partner.* The value of an equity interest in an entity that is attributable to Stock of the Corporate Partner under paragraph (c)(2)(ii) of this section is equal to the product of—

(A) The fair market value of the equity interest; and

(B) The lesser of—

(1) The ratio of the fair market value of the Stock of the Corporate Partner owned (directly or indirectly (as defined in paragraph (c)(2)(i) of this section), by the entity to the fair market value of all the equity interests in the entity; or

(2) One.

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(ii) Is not distributed to the Corporate Partner or a corporation that controls the Corporate Partner within the meaning of section 304(c) and owns directly or indirectly stock or other equity interests in the Corporate Partner. For purposes of this paragraph (f)(2), a direct or indirect ownership of an equity interest in the Corporate Partner means ownership of Stock

of the Corporate Partner that would be attributed to a person under section 318(a)(2) (except that the 50-percent ownership limitation in section 318(a)(2)(C) does not apply) and under section 318(a)(4) (but otherwise without regard to section 318).

\* \* \* \* \*

(i) *Effective/applicability date.* The regulations in this section are effective as

of the date of their publication as final regulations in the **Federal Register**.

Kirsten Wielobob,  
Deputy Commissioner for Services  
and Enforcement.

(Filed by the Office of the Federal Register on March 22, 2019, 8:45 a.m., and published in the issue of the Federal Register for March 25, 2019, 84 F.R.11005)



# Definition of Terms

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

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

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

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

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the

new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

## Abbreviations

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

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.  
E.O.—Executive Order.  
ER—Employer.

ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contributions Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
FR—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign corporation.  
G.C.M.—Chief Counsel's Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.  
PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.

PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statement of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.

## **Finding List of Current Actions on Previously Published Items<sup>1</sup>**

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<sup>1</sup>A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2018–27 through 2018–52 is in Internal Revenue Bulletin 2018–52, dated December 27, 2018.



# **Internal Revenue Service**

## **Washington, DC 20224**

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## **INTERNAL REVENUE BULLETIN**

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

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## **We Welcome Comments About the Internal Revenue Bulletin**

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