

South Carolina

NDB RWY 5 AMDT 2.

Effective: 04/28/94

FDC 4/1883/50J/ FI/P Berkely
County, Moncks Corner, SC. NDB RWY
5 AMDT 2. . . Terminal Route. . . VAN
VORTAC to MKS NDB 135.04/26.92.
This becomes NDB RWY 5 AMDT 2A.

Orangeburg

Orangeburg Muni

South Carolina

NDB RWY 5 ORIG.

Effective: 04/28/94

FDC 4/1884/OGB/ FI/P Orangeburg
Muni, Orangeburg, SC. NDB RWY 5
Orig. . . Terminal Route. . . VAN
VORTAC to OYI NDB 267.71/23.20.
This becomes NDB RWY 5 Orig A.

Summerville

Dorchester County

South Carolina

NDB RWY 5 ORIG.

Effective: 04/28/94

FDC 4/1885/DYB/ FI/P Dorchester
County, Summerville, SC. NDB RWY 5
ORIG. . . terminal route. . . VAN
VORTAC to DYB NDB 166.76/26.22.
This becomes NDB RWY 5 Orig A.

Orangeburg

Orangeburg Muni

South Carolina

VOR RWY 5 Amdt 4.

Effective: 05/05/94

FDC 4/2024/OGB/ FI/P Orangeburg
Muni, Orangeburg, SC. VOR RWY 5
AMDT 4. . . terminal route. . . VAN
VORTAC to EDS NDB 272.93/20.60.
This becomes VOR RWY 5 AMDT 4A.

Cotulla

Cotulla-La Salle County

Texas

VOR-A AMDT 11. . .

Effective: 04/29/94

FDC 4/1952/COT/ FI/P Cotulla-La
Salle County, Cotulla, TX. VOR-A
AMDT 11. . . CHG ALSTG note to
read. . . when LCL ALSTG not
received, use Laredo Intl ALSTG. This
is VOR-A Amdt 11A.

[FR Doc. 94-11727 Filed 5-12-94; 8:45 am]

BILLING CODE 4910-13-M

DEPARTMENT OF HEALTH AND
HUMAN SERVICES

Food and Drug Administration

21 CFR Part 172

[Docket No. 93F-0404]

Food Additives Permitted for Direct
Addition to Food for Human
Consumption; Glyceryl TristearateAGENCY: Food and Drug Administration,
HHS.

ACTION: Final rule.

SUMMARY: The Food and Drug
Administration (FDA) is amending the
food additive regulations to broaden
certain specifications for the safe use of
glyceryl tristearate. This action is in
response to a petition filed by Hüls
America, Inc.

DATES: Effective May 13, 1994.; written
objections and requests for a hearing by
June 13, 1994.

ADDRESSES: Submit written objections to
the Dockets Management Branch (HFA-
305), Food and Drug Administration,
rm. 1-23, 12420 Parklawn Dr.,
Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT:
Martha D. Peiperl, Center for Food
Safety and Applied Nutrition (HFS-
217), Food and Drug Administration,
200 C St. SW., Washington, DC 20204,
202-254-9515.

SUPPLEMENTARY INFORMATION: In a notice
published in the *Federal Register* of
December 3, 1993 (58 FR 63995), FDA
announced that a food additive petition
(FAP 3A4403) had been filed by Hüls
America, Inc., Turner Pl., P.O. Box 365,
Piscataway, NJ 08855-0365. The
petition proposed that the food additive
regulations in § 172.811 *Glyceryl
tristearate* (21 CFR 172.811) be amended
to broaden the specifications for the
acid number, saponification number,
and melting point for glyceryl
tristearate.

FDA has evaluated the data in the
petition and other relevant material. The
agency concludes that glyceryl
tristearate conforming to the
specifications requested by the
petitioner is safe, and that the food
additive regulations should be amended
as set forth below.

In accordance with § 171.1(h) (21 CFR
171.1(h)), the petition and the
documents that FDA considered and
relied upon in reaching its decision to
approve the petition are available for
inspection at the Center for Food Safety
and Applied Nutrition by appointment
with the information contact person
listed above. As provided in § 171.1(h),

the agency will delete from the
documents any materials that are not
available for public disclosure before
making the documents available for
inspection.

The agency has determined under 21
CFR 25.24(a)(9) that this action is of a
type that does not individually or
cumulatively have a significant effect on
the human environment. Therefore,
neither an environmental assessment
nor an environmental impact statement
is required.*

Any person who will be adversely
affected by this regulation may at any
time on or before June 13, 1994, file
with the Dockets Management Branch
(address above) written objections
thereto. Each objection shall be
separately numbered, and each
numbered objection shall specify with
particularity the provisions of the
regulation to which objection is made
and the grounds for the objection. Each
numbered objection on which a hearing
is requested shall specifically so state.
Failure to request a hearing for any
particular objection shall constitute a
waiver of the right to a hearing on that
objection. Each numbered objection for
which a hearing is requested shall
include a detailed description and
analysis of the specific factual
information intended to be presented in
support of the objection in the event
that a hearing is held. Failure to include
such a description and analysis for any
particular objection shall constitute a
waiver of the right to a hearing on the
objection. Three copies of all documents
shall be submitted and shall be
identified with the docket number
found in brackets in the heading of this
document. Any objections received in
response to the regulation may be seen
in the Dockets Management Branch
between 9 a.m. and 4 p.m., Monday
through Friday.

List of Subjects in 21 CFR Part 172

Food additives, Reporting and
recordkeeping requirements.

Therefore, under the Federal Food,
Drug, and Cosmetic Act and under
authority delegated to the Commissioner
of Food and Drugs and redelegated to
the Director, Center for Food Safety and
Applied Nutrition, 21 CFR part 172 is
amended as follows:

PART 172—FOOD ADDITIVES
PERMITTED FOR DIRECT ADDITION
TO FOOD FOR HUMAN
CONSUMPTION

1. The authority citation for 21 CFR
part 172 continues to read as follows:

Authority: Secs. 201, 401, 402, 409, 701, 721 of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321, 341, 342, 348, 371, 379e).

2. Section 172.811 is amended by revising paragraph (b) to read as follows:

§ 172.811 Glycerol tristearate

* * * * *

(b) The food additive meets the following specifications:

Acid number	Not to exceed 1.0.
Iodine number	Not to exceed 1.0.
Saponification number	186-192.
Hydroxyl number	Not to exceed 5.0.
Free glycerol content	Not to exceed 0.5 percent.
Unsaponifiable matter	Not to exceed 0.5 percent.
Melting point (Class II) ...	69 °C-73 °C.

* * * * *

Dated: May 6, 1994.

L. Robert Lake,

Acting Director, Center for Food Safety and Applied Nutrition.

[FR Doc. 94-11745 Filed 5-12-94; 8:45 am]

BILLING CODE 4160-01-F

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8539]

RIN 1545-A078

Application of Section 514(c)(9)(E) of the Internal Revenue Code to Partnerships in Which One or More (but not all) of the Partners Are Qualified Organizations Within the Meaning of Section 514(c)(9)(C)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of section 514(c)(9)(E) of the Internal Revenue Code to partnerships in which one or more (but not all) of the partners are qualified tax-exempt organizations within the meaning of section 514(c)(9)(C). These organizations include educational organizations described in section 170(b)(1)(A)(ii) and their affiliated support organizations, and qualified trusts described in section 401. The final regulations provide rules governing the application of section 514(c)(9)(E) of the Internal Revenue Code (Code). Section 514(c)(9)(E) was added to the Code by the Omnibus Budget Reconciliation Act of 1987, and was amended by the Technical and

Miscellaneous Revenue Act of 1988.

The final regulations are necessary to provide affected partnerships and their partners with the guidance they need to comply with the applicable tax law.

EFFECTIVE DATE: May 13, 1994.

For dates of applicability of these regulations, see "Effective dates" under **SUPPLEMENTARY INFORMATION** in the preamble.

FOR FURTHER INFORMATION CONTACT:

Deane M. Burke at (202) 622-3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends 26 CFR part 1, which provides rules governing the application of section 514(c)(9)(E) of the Internal Revenue Code of 1986 (Code), as amended. Section 514(c)(9)(E) was added to the Code by section 10214 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. 100-203, and was amended by section 2004(h) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647.

On June 25, 1990, Notice 90-41, 1990-1 C.B. 350, was published in the Internal Revenue Bulletin to provide interim guidance regarding the application of section 514(c)(9)(E) of the Code and to request comments. On December 30, 1992, the IRS published a notice of proposed rulemaking in the *Federal Register* (57 FR 62266) (the proposed regulations) regarding section 514(c)(9)(E). The preamble to that notice contains an explanation to the proposed rules.

The IRS received written comments on the proposed regulations, but cancelled a public hearing scheduled for March 31, 1993, because no one requested to testify. After consideration of all the public comments on the proposed regulations, the regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

I. Statutory Provisions

Section 511 of the Code provides that tax-exempt organizations are generally taxable on their unrelated business taxable income. Section 514(a) provides that unrelated business taxable income includes a specified percentage of the gross income derived from debt-financed property described in section 514(b). Section 514(c)(9) provides an exception for income derived from certain debt-financed investments in real property by qualified organizations. Under section 514(c)(9)(C), qualified organizations include educational organizations described in section 170(b)(1)(A)(ii) and their affiliated

support organizations, and qualified trusts described in section 401.

If a qualified organization (QO) invests in debt-financed real property through a partnership in which one or more (but not all) of the partners are qualified organizations, the QO is eligible for the exception provided in section 514(c)(9) only if the partnership satisfies an additional requirement. Either each allocation to a partner that is a qualified organization must be a qualified allocation within the meaning of section 168(h)(6), or the partnership must satisfy the requirements of section 514(c)(9)(E). These regulations provide rules governing the application of section 514(c)(9)(E).

II. Overview of the Regulations

To satisfy the requirements of section 514(c)(9)(E), a partnership must establish that the allocation of items to any partner that is a QO cannot result in that partner having a percentage share of overall partnership income for any taxable year greater than that partner's percentage share of overall partnership loss for the taxable year for which that partner's percentage loss share will be the smallest (that partner's fractions rule percentage). This requirement, commonly referred to as the fractions rule, must be satisfied both on a prospective basis and on an actual basis for each taxable year of the partnership.

The fractions rule is applied on an overall partnership basis. Therefore, if partnership allocations to one QO partner fail to satisfy the requirements of the fractions rule, that partner, and other QO partners in the partnership, are subject to the debt-financed property rules, even if the allocations to those other QO partners would otherwise have complied with the requirements of the fractions rule.

A second requirement under section 514(c)(9)(E) is that each partnership allocation must either have substantial economic effect or (in the case of certain allocations that cannot have economic effect) otherwise appropriately comply with the requirements of the regulations under section 704(b).

For purposes of the fractions rule, overall partnership income is the amount by which the aggregate items of partnership income and gain for the taxable year exceed the aggregate items of partnership loss and deduction for the year. Overall partnership loss is the amount by which the aggregate items of partnership loss and deduction for the taxable year exceed the aggregate items of partnership income and gain for the year. In general, all items of partnership income, gain, loss, and deduction that

increase or decrease the partners' capital accounts under § 1.704-1(b)(2)(iv) are taken into account in computing overall partnership income or loss.

The proposed regulations exclude allocations of certain items—generally by disregarding those items in computing overall partnership income or loss and the partners' allocable shares of overall partnership income or loss. In some situations, however, items are disregarded only until an allocation is actually made. The purpose of the exclusions is to allow ordinary economic business allocations (such as preferred returns), to avoid technical violations arising due to the requirements of section 704(b), and to avoid foot-faults.

III: Public Comments and Clarifying Changes

A. Manner in Which the Fractions Rule Is Applied

One commentator requested clarification regarding the prospective application of the fractions rule, especially with respect to allocations that are taken into account only when an allocation is made. The final regulations clarify that a partnership generally does not qualify for the fractions rule exception for any taxable year of its existence unless it satisfies the fractions rule—both on a prospective and actual basis—for every year. The regulations also clarify that if the partnership violates the fractions rule by reason of an allocation that the regulations provide is "disregarded" or "not taken into account" until an actual allocation is made, the partnership is treated (subject to the anti-abuse rule) as violating the fractions rule only for the taxable year of that actual allocation and subsequent taxable years. The final regulations also add an example illustrating this wait-and-see approach.

B. Section 704(c) Allocations

The proposed regulations provide that tax items allocable under section 704(c) (or § 1.704-1(b)(2)(iv)(f)(4)), are not included in computing overall partnership income or loss. The final regulations clarify that those types of tax allocations may nonetheless be relevant in determining if the partnership violates the anti-abuse rule.

C. Exclusion of Reasonable Preferred Returns and Guaranteed Payments

Under the exception for reasonable preferred returns, items of income and gain allocated with respect to a reasonable preferred return for capital are disregarded in computing overall partnership income or loss for purposes

of the fractions rule. Reasonable guaranteed payments for capital or services also are disregarded. However, to qualify for the exception, the income allocation (or the deduction of the guaranteed payment) generally must not precede the making of the related cash payment.

The final regulations adopt a commentator's recommendation that the exception for reasonable preferred returns should apply not only to allocations effected with items of income or gain, but also to allocations effected with overall partnership income. In implementing this change, the regulations refer to "an allocation of what would otherwise be overall partnership income." (This technical refinement also was made to several parts of the regulation that previously referred to allocations of overall partnership income.) This is necessary because the exclusion of an allocated item from the computation of overall partnership income or loss for purposes of the fractions rule means that the item is not overall partnership income or overall partnership loss.

Although the exception for reasonable preferred returns contained in the proposed regulations applies only to those allocations made to a QO, the final regulations apply the exception to all partners. Without this change, a partnership that paid a reasonable preferred return to both its QO and taxable partners arguably could disregard the allocations to its QO partners in computing overall partnership income or loss, but at the same time, take the corresponding allocations to its taxable partners into account in computing overall partnership income or loss. Although the anti-abuse rule of the proposed regulations does not permit the excessive allocation of income or gain to the QO partners that would result if this argument were accepted, the final regulations clarify this issue. A similar change was not called for with respect to guaranteed payments because guaranteed payments to taxable partners automatically are excluded from overall partnership income or loss.

The proposed regulations generally provide that a material distribution is a return of capital if it is not attributable to the partnership's cash flow from its business operations. Concern was expressed that under this rule certain returns on capital might inappropriately be characterized as a return of capital. There also was a separate concern that this rule inappropriately implied that distributions of operating cash flow would generally not be respected as a return of capital.

To address these concerns and to reflect that capital may be returned from a number of different sources, the final regulations provide that a designation of distributions in a written partnership agreement generally will be respected in determining a partner's unreturned capital so long as the designation is economically reasonable. Although the regulations do not specify when the designation must be made, timing may be relevant in determining whether the designation is reasonable.

Some commentators characterized the cash payment requirement as a significant limitation on the exception for preferred returns and guaranteed payments. The principal objection voiced on this point is that requiring a cash payment may prevent partners from achieving their economic deal. Since real estate partnerships often lack free cash in their early years, the money partners are forced to rely on the partnership having sufficient income in subsequent years to ultimately provide them with their preferred return.

The IRS and Treasury Department are concerned that if the requirement were eliminated, partnerships might attempt to optimize their overall economics by allocating significant amounts of partnership income and gain to QOs in the form of preferred returns and guaranteed payments. It is believed that in many instances this would be a departure from the normal commercial practice followed by partnerships in which the money partners are generally subject to income tax. Taxable partners generally are not willing to bear the tax burden attributable to income allocations that precede the corresponding distribution of cash by many years. A suggestion that partnerships be required to compound allocated but unpaid amounts could exacerbate the problem. Compounding would increase the amount of undistributed income or gain allocated to the tax-exempt partners.

The final regulations retain the cash payment requirement. However, the regulations also provide more explicitly that the normal rules of accrual accounting are overridden with respect to the deduction of reasonable guaranteed payments. The deduction is delayed until the partnership taxable year in which the payment is made in cash. (Similarly, the inclusion of the guaranteed payment in the QO's income is delayed because the regulation does not change the existing rule under § 1.707-1(c) that a guaranteed payment is included in income in the same taxable year it is deducted by the partnership.) For partnerships that are concerned about the availability of

sufficient future income to ensure the payment of a preferred return, this clarification may help them use guaranteed payments to achieve greater assurance that the partnership ultimately will pay a return on capital.

D. Chargebacks and Offsets

The final regulations continue to provide exceptions for four types of chargebacks and offsets: (1) Allocations that charge back prior disproportionately large allocations (i.e., in excess of a qualified organization's fractions rule percentage) of overall partnership loss to a qualified organization, or prior disproportionately small allocations of overall partnership income to a qualified organization; (2) minimum gain chargebacks of nonrecourse deductions; (3) chargebacks of partner nonrecourse deductions (and of compensating allocations of recourse deductions to another partner); and (4) qualified income offsets. The final regulations also continue to provide that allocations of minimum gain that may be made with respect to distributions of proceeds of nonrecourse liabilities are taken into account only to the extent an allocation is actually made (to avoid technical violations of the fractions rule that would otherwise arise from including a minimum gain chargeback provision in a partnership agreement). In addition, a limited new chargeback exception (described in greater detail below) applies to allocations of minimum gain attributable to certain distributions of proceeds of nonrecourse liabilities.

A suggestion that all chargebacks be permitted without regard to whether the initial allocation was "disproportionate" was carefully considered and rejected. A principal consideration in rejecting the proposal was that it would represent a significant departure from the mechanical approach contained in the proposed regulations, which, overall, is relatively simple for taxpayers to apply and for the IRS to administer and enforce. Accordingly, the final regulations retain the basic approach of the proposed regulations, but add a number of technical and clarifying changes. In addition, two examples have been added to further clarify the operation of these provisions.

The final regulations clarify that disproportionate allocations need not be reversed in full, but may also be reversed in part. In addition, the provision requiring that an initial allocation of less than the entire overall partnership income or loss consist of a pro rata portion of each item of partnership income, gain, loss, or

deduction now excepts from the pro rata requirement nonrecourse deductions and certain other allocations relating to nonrecourse debt. Absent this change, the disproportionate chargeback provisions might have overly limited applicability, because real estate partnerships typically have borrowed on a nonrecourse basis.

One commentator accurately noted that the exception for allocations of overall partnership loss (or, more precisely, what would otherwise be overall partnership loss) that charge back disproportionately small allocations of overall partnership income to a QO partner is somewhat confusing and counterintuitive. Part of the confusion arises because the Code refers to chargebacks of disproportionately large income allocations to taxable partners. However, the equivalent approach taken in the regulations is desirable because it avoids the need to determine the analog of a fractions rule percentage for taxable partners and because it is simpler to apply to partnerships with more than one QO partner. Accordingly, an example has been added to the final regulations, as requested by the commentator, to illustrate a qualifying allocation of overall partnership loss that charges back a disproportionately small allocation of overall partnership income to a QO partner.

The final regulations revise the formula approach in the proposed regulations for determining the extent to which a minimum gain chargeback is attributable to nonrecourse deductions (or partner nonrecourse deductions) to properly interact with the § 1.704-2 regulations governing partnership minimum gain and partner nonrecourse debt minimum gain. The § 1.704-2 regulations effect minimum gain chargebacks on the basis of the partners' percentage shares of minimum gain. Accordingly, the final regulations require partnerships to determine—in a reasonable and consistent manner—the extent to which a partner's percentage share of the partnership minimum gain is attributable to nonrecourse deductions. The final regulations also provide, by way of example, a formula for determining in certain circumstances the extent to which a partner's percentage share of minimum gain is attributable to nonrecourse deductions. Although the final regulations do not explicitly so provide, a partnership that computes the extent to which minimum gain is attributable to nonrecourse deductions, also computes, by default, the extent to which minimum gain is attributable to prior distributions of proceeds of nonrecourse liabilities.

There is a limited new chargeback exception that applies if QO partners initially contribute capital used to purchase depreciable real property and are allocated the resulting depreciation deductions. If the partnership later borrows money on a nonrecourse basis (using that depreciable real property as security) and distributes the proceeds to the QO partners as a return of capital, the resulting minimum gain chargeback is permanently disregarded in computing overall partnership income or loss for purposes of the fractions rule. Without a special rule, the distribution of nonrecourse proceeds and the resulting minimum gain chargeback might cause a violation of the fractions rule in the year the minimum gain is triggered. In effect, the new exception allows the partnership to apply the general chargeback rule for nonrecourse deductions (rather than the general chargeback rule for nonrecourse distributions) even though the initial depreciation deductions allocated to the QO partners were not nonrecourse.

This new rule is narrow. It provides complete relief to partnerships only to the extent the amount of the partnership depreciation deduction for the property for the year does not exceed the overall partnership loss for the year. The reason for making this rule narrow is that chargebacks attributable to distributions of proceeds of nonrecourse liabilities may provide greater potential for manipulation than other chargebacks. Nonetheless, the new provision should provide significant relief from a problem that may be fairly common.

E. Exclusion of Partner-Specific Items of Deduction

The final regulations continue to exclude from the computation of overall partnership income or loss, certain expenditures allocated to the partners to whom they are attributable. Furthermore, in partial response to a commentator's request that certain other exceptions be added, the final regulations expand the exception for expenditures incurred in computing section 743(b) basis adjustments to generally encompass additional record-keeping and accounting expenditures incurred in connection with transfers of partnership interests. To allow proper consideration of other items that might be excepted, the final regulations also permit the list of qualifying expenditures to be expanded in the future by revenue ruling, revenue procedure, or private letter ruling.

F. Unlikely Losses and Deductions

The requirement that a loss or expenditure not be reasonably

foreseeable to qualify as unlikely has been revised in response to concerns that were voiced. To qualify as "unlikely" under the final regulations, a loss or deduction must have a low likelihood of occurring, taking into account the relevant facts and circumstances.

In addition, the final regulations clarify that the types of events described in the regulations are not per se unlikely. They merely illustrate possible situations giving rise to allocations to which the exception for unlikely losses and deductions applies (if they have a low likelihood of occurring taking into account the relevant facts and circumstances). In response to a comment, the discovery of environmental conditions that require remediation has been added to the illustrative list of potential relevant events.

Contrary to a commentator's request, the final regulations do not sanction pre-funding of a loss or deduction. Generally, pre-funding is incompatible with a conclusion that a loss or deduction is unlikely.

G. Changes in Partnership Allocations

The final regulations retain the rule that changes in partnership allocations resulting from transfers or shifts in partnership interests will be closely scrutinized, but generally will be relevant only on a prospective basis. However, the final regulations provide taxpayers with more specific guidance. The scope of the scrutiny relates to the determination of whether the transfers or shifts stem from a prior agreement, understanding, or plan, or could otherwise be expected given the structure of the transaction (e.g., a situation where the structure and economics is such that it could well be anticipated that a sale of an interest would occur at some particular phase of the partnership's (or transaction's) life). This approach bears some similarity to the approach of § 1.704-1(b)(4)(vi) (relating to the scrutiny given to amendments to partnership agreements).

H. De Minimis Exceptions

In response to comments, changes were also made to the two *de minimis* rules. One commentator asked for clarification on the exception for *de minimis* interests. In response, the rule has been slightly clarified and an example has been added to illustrate the rule's application.

The nature of the comments received with respect to the *de minimis* allocation exception indicated that the exception was viewed differently than

had been intended. The intent of this exception was to provide relief for what would otherwise be minor inadvertent violations of the fractions rule. One example would be a plumber's bill that is paid directly by a taxable partner, or that is paid by the partnership but is overlooked until after the partnership's allocations have been computed and then is allocated entirely to the taxable partner. It was not intended that this provision be used routinely by partnerships to allocate some of the partnership's losses and deductions. Consistent with the intent underlying this provision, the final regulations limit the total amount (rather than the amount allocated to the QO partner) to which the exception applies to the lesser of \$50,000 and one percent of the partnership's total losses and deductions.

I. Anti-Abuse Rule

At least one commentator suggested that the anti-abuse rule in the proposed regulations was vague. To address this concern, the final regulations provide a more complete statement of the purpose of the fractions rule, which largely tracks the wording of the Conference Committee Report accompanying the enactment of the Revenue Act of 1987. See H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 957 (1987).

J. Tiered Partnerships

The rules regarding tiered partnerships were well received and remain largely the same as in the proposed regulations. However, some changes were made. First, the final regulations clarify that the relevant partnerships (as opposed to individual QOs) must demonstrate that the relevant chains satisfy the requirements of the regulations under any reasonable method. Also, although the same three basic examples contained in the proposed regulations continue to illustrate the application of this rule, a number of changes were made to those examples. Most of the changes to the examples are stylistic or clarifying.

One clarification is that tiered partnerships may not simply be used to achieve results that could not be achieved in the absence of a tiered-partnership structure. For example, the facts in the second tiered-partnership example (relating to the entity-by-entity approach) now state that each of the upper-tier partnerships has been established for the purpose of investing in numerous real estate properties independently of the other upper-tier partnership and its partners. Thus, the tiered-partnership rules may not be used simply to apply the fractions rule on a

QO-by-QO basis instead of the regulation's generally applicable overall partnership basis.

The facts in the second example also now contain a statement that neither of the upper-tier partnerships have outstanding debt. The reason for that statement is that in some cases, debt might be used to attempt to achieve allocations that would not satisfy the fractions rule if, for example, the lower-tier partnership had incurred the debt. The inclusion of this added fact should not be viewed as flatly precluding the existence of debt at any level other than the lower-tier partnership. The absence of debt was added as a fact to obviate the need to complicate the example by addressing the precise effect of debt, in what likely would have been a fact pattern that would have been of limited value in analyzing other debt arrangements. Accordingly, the existence of debt at a level other than the lower-tier partnership should be viewed as something to be taken into consideration in determining whether a partnership can demonstrate that the requirements of the regulations have been satisfied. It should also be noted that the existence of debt at the partner level might also be relevant in situations where tiered partnerships are not used.

One clarifying change and one technical change were made with respect to the third example in the tiered-partnership rules (relating to the independent chain approach). The clarifying change was to state that the upper-tier partnership separately allocates to its upper-tier partners the items allocated to the upper-tier partnership by the lower-tier partnerships. This change emphasizes that, as a practical matter, partnerships would not otherwise be able to demonstrate that the requirements of the fractions rule are complied with.

The technical change, which is related, is to provide that for purposes of applying § 1.704-2(k) under the independent chain approach, minimum gain chargebacks are taken into account on an if-and-when basis. Absent this change, no tiered-partnership structure in which a lower-tier partnership incurred nonrecourse debt would be able to comply with the fractions rule. This is because § 1.704-2(k) would be treated on a prospective basis as giving rise to: (1) an allocation of a decrease in minimum gain to the upper-tier partnership (and, in turn, an upper-tier QO partner) from one lower-tier partnership lacking sufficient income and gain to effect a minimum gain chargeback; and (2) a corresponding minimum gain chargeback by the upper-tier partnership using income and gain

allocated to the upper-tier partnership by the other lower-tier partnership.

K. Effective Date

The final regulations retain December 30, 1992, as their general effective date, i.e., the date the proposed regulations were published in the *Federal Register*. However, the final regulations also permit reliance on the proposed regulations during the window period beginning December 30, 1992, and ending on May 13, 1994. The regulations provide transition rules for partnerships commencing after October 13, 1987, property acquired by partnerships after October 13, 1987, and partnership interests acquired by qualified organizations after October 13, 1987.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Deane M. Burke, Office of Assistant Chief Counsel (Passthroughs and Special Industries), Internal Revenue Service. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income Taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

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

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

Section 1.514(c)-2 also issued under 26 U.S.C. 514(c)(9)(E)(iii). * * *

Par. 2. Section 1.514(c)-2 is added to read as follows:

§ 1.514(c)-2. Permitted allocations under section 514(c)(9)(E).

(a) *Table of contents.* This paragraph contains a listing of the major headings of this § 1.514(c)-2.

- (a) Table of contents.
- (b) Application of section 514(c)(9)(E), relating to debt-financed real property held by partnerships.
 - (1) In general.
 - (i) The fractions rule.
 - (ii) Substantial economic effect.
 - (2) Manner in which fractions rule is applied.
 - (i) In general.
 - (ii) Subsequent changes.
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 - (5) Material modifications to partnership agreements.
- (b) *Application of section 514(c)(9)(E), relating to debt-financed real property held by partnerships—(1) In general.* This § 1.514(c)-2 provides rules governing the application of section 514(c)(9)(E). To comply with section 514(c)(9)(E), the following two requirements must be met:
- (i) *The fractions rule.* The allocation of items to a partner that is a qualified organization cannot result in that partner having a percentage share of overall partnership income for any partnership taxable year greater than that partner's fractions rule percentage (as defined in paragraph (c)(2) of this section).
 - (ii) *Substantial economic effect.* Each partnership allocation must have substantial economic effect. However, allocations that cannot have economic effect must be deemed to be in accordance with the partners' interests in the partnership pursuant to § 1.704-1(b)(4), or (if § 1.704-1(b)(4) does not provide a method for deeming the allocations to be in accordance with the partners' interests in the partnership) must otherwise comply with the requirements of § 1.704-1(b)(4). Allocations attributable to nonrecourse liabilities or partner nonrecourse debt must comply with the requirements of § 1.704-2(e) or § 1.704-2(i).
- (2) *Manner in which fractions rule is applied—(i) In general.* A partnership must satisfy the fractions rule both on a prospective basis and on an actual basis for each taxable year of the partnership, commencing with the first taxable year of the partnership in which the partnership holds debt-financed real property and has a qualified organization as a partner. Generally, a partnership does not qualify for the unrelated business income tax exception provided by section 514(c)(9)(A) for any taxable year of its existence unless it satisfies the fractions

rule for every year the fractions rule applies. However, if an actual allocation described in paragraph (e)(4), (h), (j)(2), or (m)(1)(ii) of this section (regarding certain allocations that are disregarded or not taken into account for purposes of the fractions rule until an actual allocation is made) causes the partnership to violate the fractions rule, the partnership ordinarily is treated as violating the fractions rule only for the taxable year of the actual allocation and subsequent taxable years. For purposes of applying the fractions rule, the term *partnership agreement* is defined in accordance with § 1.704-1(b)(2)(ii)(h), and informal understandings are considered part of the partnership agreement in appropriate circumstances. See paragraph (k) of this section for rules relating to changes in the partners' interests and *de minimis* exceptions to the fractions rule.

(ii) *Subsequent changes.* A subsequent change to a partnership agreement that causes the partnership to violate the fractions rule ordinarily causes the partnership's income to fail the exception provided by section 514(c)(9)(A) only for the taxable year of the change and subsequent taxable years.

(c) *General definitions.*—(1) *Overall partnership income and loss.* Overall partnership income is the amount by which the aggregate items of partnership income and gain for the taxable year exceed the aggregate items of partnership loss and deduction for the year. Overall partnership loss is the amount by which the aggregate items of partnership loss and deduction for the taxable year exceed the aggregate items of partnership income and gain for the year.

(i) *Items taken into account in determining overall partnership income and loss.* Except as otherwise provided in this section, the partnership items that are included in computing overall partnership income or loss are those items of income, gain, loss, and deduction (including expenditures described in section 705(a)(2)(B)) that increase or decrease the partners' capital accounts under § 1.704-1(b)(2)(iv). Tax items allocable pursuant to section 704(c) or § 1.704-1(b)(2)(iv)(f)(4) are not included in computing overall partnership income or loss.

Nonetheless, allocations pursuant to section 704(c) or § 1.704-1(b)(2)(iv)(f)(4) may be relevant in determining that this section is being applied in a manner that is inconsistent with the fractions rule. See paragraph (k)(4) of this section.

(ii) *Guaranteed payments to qualified organizations.* Except to the extent

otherwise provided in paragraph (d) of this section—

(A) A guaranteed payment to a qualified organization is not treated as an item of partnership loss or deduction in computing overall partnership income or loss; and

(B) Income that a qualified organization may receive or accrue with respect to a guaranteed payment is treated as an allocable share of overall partnership income or loss for purposes of the fractions rule.

(2) *Fractions rule percentage.* A qualified organization's fractions rule percentage is that partner's percentage share of overall partnership loss for the partnership taxable year for which that partner's percentage share of overall partnership loss will be the smallest.

(3) *Definitions of certain terms by cross reference to partnership regulations.* Minimum gain chargeback, nonrecourse deduction, nonrecourse liability, partner nonrecourse debt, partner nonrecourse debt minimum gain, partner nonrecourse debt minimum gain chargeback, partner nonrecourse deduction, and partnership minimum gain have the meanings provided in § 1.704-2.

(4) *Example.* The following example illustrates the provisions of this paragraph (c).

Example. Computation of overall partnership income and loss for a taxable year. (i) Taxable corporation TP and qualified organization QO form a partnership to own and operate encumbered real property. Under the partnership agreement, all items of income, gain, loss, deduction, and credit are allocated 50 percent to TP and 50 percent to QO. Neither partner is entitled to a preferred return. However, the partnership agreement provides for a \$900 guaranteed payment for services to QO in each of the partnership's first two taxable years. No part of the guaranteed payments qualify as a reasonable guaranteed payment under paragraph (d) of this section.

(ii) The partnership violates the fractions rule. Due to the existence of the guaranteed payment, QO's percentage share of any overall partnership income in the first two years will exceed QO's fractions rule percentage. For example, the partnership might have bottom-line net income of \$5,100 in its first taxable year that is comprised of \$10,000 of rental income, \$4,000 of salary expense, and the \$900 guaranteed payment to QO. The guaranteed payment would not be treated as an item of deduction in computing overall partnership income or loss because it does not qualify as a reasonable guaranteed payment. See paragraph (c)(1)(ii)(A) of this section. Accordingly, overall partnership income for the year would be \$6,000, which would consist of \$10,000 of rental income less \$4,000 of salary expense. See paragraph (c)(1)(i) of this section. The \$900 QO would include in income with respect to the guaranteed payment would be treated as an

allocable share of the \$6,000 of overall partnership income. See paragraph (c)(1)(ii)(B) of this section. Therefore, QO's allocable share of the overall partnership income for the year would be \$3,450, which would be comprised of the \$900 of income pertaining to QO's guaranteed payment, plus QO's \$2,550 allocable share of the partnership's net income for the year (50 percent of \$5,100). QO's \$3,450 allocable share of overall partnership income would equal 58 percent of the \$6,000 of overall partnership income and would exceed QO's fractions rule percentage, which is less than 50 percent. (If there were no guaranteed payment, QO's fractions rule percentage would be 50 percent. However, the existence of the guaranteed payment to QO that is not disregarded for purposes of the fractions rule pursuant to paragraph (d) of this section means that QO's fractions rule percentage is less than 50 percent.)

(d) *Exclusion of reasonable preferred returns and guaranteed payments.*—(1) *Overview.* This paragraph (d) sets forth requirements for disregarding reasonable preferred returns for capital and reasonable guaranteed payments for capital or services for purposes of the fractions rule. To qualify, the preferred return or guaranteed payment must be set forth in a binding, written partnership agreement.

(2) *Preferred returns.* Items of income (including gross income) and gain that may be allocated to a partner with respect to a current or cumulative reasonable preferred return for capital (including allocations of minimum gain attributable to nonrecourse liability (or partner nonrecourse debt) proceeds distributed to the partner as a reasonable preferred return) are disregarded in computing overall partnership income or loss for purposes of the fractions rule. Similarly, if a partnership agreement effects a reasonable preferred return with an allocation of what would otherwise be overall partnership income, those items comprising that allocation are disregarded in computing overall partnership income for purposes of the fractions rule.

(3) *Guaranteed payments.* A current or cumulative reasonable guaranteed payment to a qualified organization for capital or services is treated as an item of deduction in computing overall partnership income or loss, and the income that the qualified organization may receive or accrue from the current or cumulative reasonable guaranteed payment is not treated as an allocable share of overall partnership income or loss. The treatment of a guaranteed payment as reasonable for purposes of section 514(c)(9)(E) does not affect its possible characterization as unrelated business taxable income under other

provisions of the Internal Revenue Code.

(4) *Reasonable amount*—(i) *In general.* A guaranteed payment for services is reasonable only to the extent the amount of the payment is reasonable under § 1.162-7 (relating to the deduction of compensation for personal services). A preferred return or guaranteed payment for capital is reasonable only to the extent it is computed, with respect to unreturned capital, at a rate that is commercially reasonable based on the relevant facts and circumstances.

(ii) *Safe harbor.* For purposes of this paragraph (d)(4), a rate is deemed to be commercially reasonable if it is no greater than four percentage points more than, or if it is no greater than 150 percent of, the highest long-term applicable federal rate (AFR) within the meaning of section 1274(d), for the month the partner's right to a preferred return or guaranteed payment is first established or for any month in the partnership taxable year for which the return or payment on capital is computed. A rate in excess of the rates described in the preceding sentence may be commercially reasonable, based on the relevant facts and circumstances.

(5) *Unreturned capital*—(i) *In general.* Unreturned capital is computed on a weighted-average basis and equals the excess of—

(A) The amount of money and the fair market value of property contributed by the partner to the partnership (net of liabilities assumed, or taken subject to, by the partnership); over

(B) The amount of money and the fair market value of property (net of liabilities assumed, or taken subject to, by the partner) distributed by the partnership to the partner as a return of capital.

(ii) *Return of capital.* In determining whether a distribution constitutes a return of capital, all relevant facts and circumstances are taken into account. However, the designation of distributions in a written partnership agreement generally will be respected in determining whether a distribution constitutes a return of capital, so long as the designation is economically reasonable.

(6) *Timing rules*—(i) *Limitation on allocations of income with respect to reasonable preferred returns for capital.* Items of income and gain (or part of what would otherwise be overall partnership income) that may be allocated to a partner in a taxable year with respect to a reasonable preferred return for capital are disregarded for purposes of the fractions rule only to the

extent the allocable amount will not exceed—

(A) The aggregate of the amount that has been distributed to the partner as a reasonable preferred return for the taxable year of the allocation and prior taxable years, on or before the due date (not including extensions) for filing the partnership's return for the taxable year of the allocation; minus

(B) The aggregate amount of corresponding income and gain (and what would otherwise be overall partnership income) allocated to the partner in all prior years.

(ii) *Reasonable guaranteed payments may be deducted only when paid in cash.* If a partnership that avails itself of paragraph (d)(3) of this section would otherwise be required (by virtue of its method of accounting) to deduct a reasonable guaranteed payment to a qualified organization earlier than the taxable year in which it is paid in cash, the partnership must delay the deduction of the guaranteed payment until the taxable year it is paid in cash. For purposes of this paragraph (d)(6)(ii), a guaranteed payment that is paid in cash on or before the due date (not including extensions) for filing the partnership's return for a taxable year may be treated as paid in that prior taxable year.

(7) *Examples.* The following examples illustrate the provisions of this paragraph (d).

Facts. Qualified organization QO and taxable corporation TP form a partnership. QO contributes \$9,000 to the partnership and TP contributes \$1,000. The partnership borrows \$50,000 from a third party lender and purchases an office building for \$55,000. At all relevant times the safe harbor rate described in paragraph (d)(4)(ii) of this section equals 10 percent.

Example 1. Allocations made with respect to preferred returns. (i) The partnership agreement provides that in each taxable year the partnership's distributable cash is first to be distributed to QO as a 10 percent preferred return on its unreturned capital. To the extent the partnership has insufficient cash to pay QO its preferred return in any taxable year, the preferred return is compounded (at 10 percent) and is to be paid in future years to the extent the partnership has distributable cash. The partnership agreement first allocates gross income and gain 100 percent to QO, to the extent cash has been distributed to QO as a preferred return. All remaining profit or loss is allocated 50 percent to QO and 50 percent to TP.

(ii) The partnership satisfies the fractions rule. Items of income and gain that may be specially allocated to QO with respect to its preferred return are disregarded in computing overall partnership income or loss for purposes of the fractions rule because the requirements of paragraph (d) of this section are satisfied. After disregarding those allocations, QO's fractions rule percentage is

50 percent (see paragraph (c)(2) of this section), and under the partnership agreement QO may not be allocated more than 50 percent of overall partnership income in any taxable year.

(iii) The facts are the same as in paragraph (i) of this Example 1, except that QO's preferred return is computed on unreturned capital at a rate that exceeds a commercially reasonable rate. The partnership violates the fractions rule. The income and gain that may be specially allocated to QO with respect to the preferred return is not disregarded in computing overall partnership income or loss to the extent it exceeds a commercially reasonable rate. See paragraph (d) of this section. As a result, QO's fractions rule percentage is less than 50 percent (see paragraph (c)(2) of this section), and allocations of income and gain to QO with respect to its preferred return could result in QO being allocated more than 50 percent of the overall partnership income in a taxable year.

Example 2. Guaranteed payments and the computation of overall partnership income or loss. (i) The partnership agreement allocates all bottom-line partnership income and loss 50 percent to QO and 50 percent to TP throughout the life of the partnership. The partnership agreement provides that QO is entitled each year to a 10 percent guaranteed payment on unreturned capital. To the extent the partnership is unable to make a guaranteed payment in any taxable year, the unpaid amount is compounded at 10 percent and is to be paid in future years.

(ii) Assuming the requirements of paragraph (d)(6)(ii) of this section are met, the partnership satisfies the fractions rule. The guaranteed payment is disregarded for purposes of the fractions rule because it is computed with respect to unreturned capital at the safe harbor rate described in paragraph (d)(4)(ii) of this section. Therefore, the guaranteed payment is treated as an item of deduction in computing overall partnership income or loss, and the corresponding income that QO may receive or accrue with respect to the guaranteed payment is not treated as an allocable share of overall partnership income or loss. See paragraph (d)(3) of this section. Accordingly, QO's fractions rule percentage is 50 percent (see paragraph (c)(2) of this section), and under the partnership agreement QO may not be allocated more than 50 percent of overall partnership income in any taxable year.

(e) *Chargebacks and offsets*—(1) *In general.* The following allocations are disregarded in computing overall partnership income or loss for purposes of the fractions rule—

(i) Allocations of what would otherwise be overall partnership income that may be made to chargeback (i.e., reverse) prior disproportionately large allocations of overall partnership loss (or part of the overall partnership loss) to a qualified organization, and allocations of what would otherwise be overall partnership loss that may be made to chargeback prior disproportionately small allocations of

overall partnership income (or part of the overall partnership income) to a qualified organization;

(ii) Allocations of income or gain that may be made to a partner pursuant to a minimum gain chargeback attributable to prior allocations of nonrecourse deductions to the partner;

(iii) Allocations of income or gain that may be made to a partner pursuant to a minimum gain chargeback attributable to prior allocations of partner nonrecourse deductions to the partner and allocations of income or gain that may be made to other partners to chargeback compensating allocations of other losses, deductions, or section 705(a)(2)(B) expenditures to the other partners; and

(iv) Allocations of items of income or gain that may be made to a partner pursuant to a qualified income offset, within the meaning of § 1.704-1(b)(2)(ii)(d).

(2) *Disproportionate allocations*—(i) *In general.* To qualify under paragraph (e)(1)(i) of this section, prior disproportionate allocations may be reversed in full or in part, and in any order, but must be reversed in the same ratio as originally made. A prior allocation is disproportionately large if the qualified organization's percentage share of that allocation exceeds its fractions rule percentage. A prior allocation is disproportionately small if the qualified organization's percentage share of that allocation is less than its fractions rule percentage. However, a prior allocation (or allocations) is not considered disproportionate unless the balance of the overall partnership income or loss for the taxable year of the allocation is allocated in a manner that would independently satisfy the fractions rule.

(ii) *Limitation on chargebacks of partial allocations.* Except in the case of a chargeback allocation pursuant to paragraph (e)(4) of this section, and except as otherwise provided by the Internal Revenue Service by revenue ruling, revenue procedure, or, on a case-by-case basis, by letter ruling, paragraph (e)(1)(i) of this section applies to a chargeback of an allocation of part of the overall partnership income or loss only if that part consists of a pro rata portion of each item of partnership income, gain, loss, and deduction (other than nonrecourse deductions, as well as partner nonrecourse deductions and compensating allocations) that is included in computing overall partnership income or loss.

(3) *Minimum gain chargebacks attributable to nonrecourse deductions.* Commencing with the first taxable year of the partnership in which a minimum

gain chargeback (or partner nonrecourse debt minimum gain chargeback) occurs, a chargeback to a partner is attributable to nonrecourse deductions (or separately, on a debt-by-debt basis, to partner nonrecourse deductions) in the same proportion that the partner's percentage share of the partnership minimum gain (or separately, on a debt-by-debt basis, the partner nonrecourse debt minimum gain) at the end of the immediately preceding taxable year is attributable to nonrecourse deductions (or partner nonrecourse deductions). The partnership must determine the extent to which a partner's percentage share of the partnership minimum gain (or partner nonrecourse debt minimum gain) is attributable to deductions in a reasonable and consistent manner. For example, in those cases in which none of the exceptions contained in § 1.704-2(f)(2) through (5) are relevant, a partner's percentage share of the partnership minimum gain generally is attributable to nonrecourse deductions in the same ratio that—

(i) The aggregate amount of the nonrecourse deductions previously allocated to the partner but not charged back in prior taxable years; bears to

(ii) The sum of the amount described in paragraph (e)(3)(i) of this section, plus the aggregate amount of distributions previously made to the partner of proceeds of a nonrecourse liability allocable to an increase in partnership minimum gain but not charged back in prior taxable years.

(4) *Minimum gain chargebacks attributable to distribution of nonrecourse debt proceeds*—(i) *Chargebacks disregarded until allocations made.* Allocations of items of income and gain that may be made pursuant to a provision in the partnership agreement that charges back minimum gain attributable to the distribution of proceeds of a nonrecourse liability (or a partner nonrecourse debt) are taken into account for purposes of the fractions rule only to the extent an allocation is made. (See paragraph (d)(2) of this section, pursuant to which there is permanently excluded chargeback allocations of minimum gain that are attributable to proceeds distributed as a reasonable preferred return.)

(ii) *Certain minimum gain chargebacks related to returns of capital.* Allocations of items of income or gain that (in accordance with § 1.704-2(f)(1)) may be made to a partner pursuant to a minimum gain chargeback attributable to the distribution of proceeds of a nonrecourse liability are disregarded in computing overall partnership income or loss for purposes

of the fractions rule to the extent that the allocations (subject to the requirements of paragraph (e)(2) of this section) also charge back prior disproportionately large allocations of overall partnership loss (or part of the overall partnership loss) to a qualified organization. This exception applies only to the extent the disproportionately large allocation consisted of depreciation from real property (other than items of nonrecourse deduction or partner nonrecourse deduction) that subsequently was used to secure the nonrecourse liability providing the distributed proceeds, and only if those proceeds were distributed as a return of capital and in the same proportion as the disproportionately large allocation.

(5) *Examples.* The following examples illustrate the provisions of this paragraph (e).

Example 1. Chargebacks of disproportionately large allocations of overall partnership loss. (i) Qualified organization QO and taxable corporation TP form a partnership. QO contributes \$900 to the partnership and TP contributes \$100. The partnership agreement allocates overall partnership loss 50 percent to QO and 50 percent to TP until TP's capital account is reduced to zero; then 100 percent to QO until QO's capital account is reduced to zero; and thereafter 50 percent to QO and 50 percent to TP. *Overall partnership income* is allocated first 100 percent to QO to chargeback overall partnership loss allocated 100 percent to QO, and thereafter 50 percent to QO and 50 percent to TP.

(ii) The partnership satisfies the fractions rule. QO's fractions rule percentage is 50 percent. See paragraph (c)(2) of this section. Therefore, the 100 percent allocation of overall partnership loss to QO is disproportionately large. See paragraph (e)(2)(i) of this section. Accordingly, the 100 percent allocation to QO of what would otherwise be overall partnership income (if it were not disregarded), which charges back the disproportionately large allocation of overall partnership loss, is disregarded in computing overall partnership income and loss for purposes of the fractions rule. The 100 percent allocation is in the same ratio as the disproportionately large loss allocation, and the rest of the allocations for the taxable year of the disproportionately large loss allocation will independently satisfy the fractions rule. See paragraph (e)(2)(i) of this section. After disregarding the chargeback allocation of 100 percent of what would otherwise be overall partnership income, QO will not be allocated a percentage share of overall partnership income in excess of its fractions rule percentage for any taxable year.

Example 2. Chargebacks of disproportionately small allocations of overall partnership income. (i) Qualified organization QO and taxable corporation TP form a partnership. QO contributes \$900 to the partnership and TP contributes \$100. The partnership purchases real property with money contributed by its partners and with

money borrowed by the partnership on a recourse basis. In any year, the partnership agreement allocates the first \$500 of overall partnership income 50 percent to QO and 50 percent to TP; the next \$100 of overall partnership income 100 percent to TP (as an incentive for TP to achieve significant profitability in managing the partnership's operations); and all remaining overall partnership income 50 percent to QO and 50 percent to TP. Overall partnership loss is allocated first 100 percent to TP to chargeback overall partnership income allocated 100 percent to TP at any time in the prior three years and not reversed; and thereafter 50 percent to QO and 50 percent to TP.

(ii) The partnership satisfies the fractions rule. QO's fractions rule percentage is 50 percent because qualifying chargebacks are disregarded pursuant to paragraph (e)(1)(i) in computing overall partnership income or loss. See paragraph (c)(2) of this section. The zero percent allocation to QO of what would otherwise be overall partnership loss is a qualifying chargeback that is disregarded because it is in the same ratio as the income allocation it charges back, because the rest of the allocations for the taxable year of that income allocation will independently satisfy the fractions rule (see paragraph (e)(2)(i) of this section), and because it charges back an allocation of zero overall partnership income to QO, which is proportionately smaller (i.e., disproportionately small) than QO's 50 percent fractions rule percentage. After disregarding the chargeback allocation of 100 percent of what would otherwise be overall partnership loss, QO will not be allocated a percentage share of overall partnership income in excess of its fractions rule percentage for any taxable year.

Example 3. Chargebacks of partner nonrecourse deductions and compensating allocations of other items. (i) Qualified organization QO and taxable corporation TP form a partnership to own and operate encumbered real property. QO and TP each contribute \$500 to the partnership. In addition, QO makes a \$300 nonrecourse loan to the partnership. The partnership agreement contains a partner nonrecourse debt minimum gain chargeback provision and a provision that allocates partner nonrecourse deductions to the partner who bears the economic burden of the deductions in accordance with § 1.704-2. The partnership agreement also provides that to the extent partner nonrecourse deductions are allocated to QO in any taxable year, other compensating items of partnership loss or deduction (and, if appropriate, section 705(a)(2)(B) expenditures) will first be allocated 100 percent to TP. In addition, to the extent items of income or gain are allocated to QO in any taxable year pursuant to a partner nonrecourse debt minimum gain chargeback of deductions, items of partnership income and gain will first be allocated 100 percent to TP. The partnership agreement allocates all other overall partnership income or loss 50 percent to QO and 50 percent to TP.

(ii) The partnership satisfies the fractions rule on a prospective basis. The allocations of the partner nonrecourse deductions and

the compensating allocation of other items of loss, deduction, and expenditure that may be made to TP (but which will not be made unless there is an allocation of partner nonrecourse deductions to QO) are not taken into account for purposes of the fractions rule until a taxable year in which an allocation is made. See paragraph (j)(1) of this section. In addition, partner nonrecourse debt minimum gain chargebacks of deductions and allocations of income or gain to other partners that chargeback compensating allocations of other deductions are disregarded in computing overall partnership income or loss for purposes of the fractions rule. See paragraph (e)(1)(iii) of this section. Since all other overall partnership income and loss is allocated 50 percent to QO and 50 percent to TP, QO's fractions rule percentage is 50 percent (see paragraph (c)(2) of this section), and QO will not be allocated a percentage share of overall partnership income in excess of its fractions rule percentage for any taxable year.

(iii) The facts are the same as in paragraph (i) of this Example 3, except that the partnership agreement provides that compensating allocations of loss or deduction (and section 705(a)(2)(B) expenditures) to TP will not be charged back until year 10. The partners expect \$300 of partner nonrecourse deductions to be allocated to QO in year 1 and \$300 of income or gain to be allocated to QO in year 2 pursuant to the partner nonrecourse debt minimum gain chargeback provision.

(iv) The partnership fails to satisfy the fractions rule on a prospective basis under the anti-abuse rule of paragraph (k)(4) of this section. If the partners' expectations prove correct, at the end of year 2, QO will have been allocated \$300 of partner nonrecourse deductions and an offsetting \$300 of partner nonrecourse debt minimum gain. However, the \$300 of compensating deductions and losses that may be allocated to TP will not be charged back until year 10. Thus, during the period beginning at the end of year 2 and ending eight years later, there may be \$300 more of unreversed deductions and losses allocated to TP than to QO, which would be inconsistent with the purpose of the fractions rule.

Example 4. Minimum gain chargeback attributable to distributions of nonrecourse debt proceeds. (i) Qualified organization QO and taxable corporation TP form a partnership. QO contributes \$900 to the partnership and TP contributes \$100. The partnership agreement generally allocates overall partnership income and loss 90 percent to QO and 10 percent to TP. However, the partnership agreement contains a minimum gain chargeback provision, and also provides that in any partnership taxable year in which there is a chargeback of partnership minimum gain to QO attributable to distributions of proceeds of nonrecourse liabilities, all other items comprising overall partnership income or loss will be allocated in a manner such that QO is not allocated more than 90 percent of the overall partnership income for the year.

(ii) The partnership satisfies the fractions rule on a prospective basis. QO's fractions rule percentage is 90 percent. See paragraph

(c)(2) of this section. The chargeback that may be made to QO of minimum gain attributable to distributions of nonrecourse liability proceeds is taken into account for purposes of the fractions rule only to the extent an allocation is made. See paragraph (e)(4) of this section. Accordingly, that potential allocation to QO is disregarded in applying the fractions rule on a prospective basis (see paragraph (b)(2) of this section), and QO is treated as not being allocated a percentage share of overall partnership income in excess of its fractions rule percentage in any taxable year. (Similarly, QO is treated as not being allocated items of income or gain in a taxable year when the partnership has an overall partnership loss.)

(iii) In year 3, the partnership borrows \$400 on a nonrecourse basis and distributes it to QO as a return of capital. In year 8, the partnership has \$400 of gross income and cash flow and \$300 of overall partnership income, and the partnership repays the \$400 nonrecourse borrowing.

(iv) The partnership violates the fractions rule for year 8 and all future years. Pursuant to the minimum gain chargeback provision, the entire \$400 of partnership gross income is allocated to QO. Accordingly, notwithstanding the curative provision in the partnership agreement that would allocate to TP the next \$44 $((\$400 \div 9) \times 10\%)$ of income and gain included in computing overall partnership income, the partnership has no other items of income and gain to allocate to QO. Because the \$400 of gross income actually allocated to QO is taken into account for purposes of the fractions rule in the year an allocation is made (see paragraph (e)(4) of this section), QO's percentage share of overall partnership income in year 8 is greater than 100 percent. Since this exceeds QO's fractions rule percentage (i.e., 90 percent), the partnership violates the fractions rule for year 8 and all subsequent taxable years. See paragraph (b)(2) of this section.

(f) Exclusion of reasonable partner-specific items of deduction or loss. Provided that the expenditures are allocated to the partners to whom they are attributable, the following partner-specific expenditures are disregarded in computing overall partnership income or loss for purposes of the fractions rule—

(1) Expenditures for additional record-keeping and accounting incurred in connection with the transfer of a partnership interest (including expenditures incurred in computing basis adjustments under section 743(b));

(2) Additional administrative costs that result from having a foreign partner;

(3) State and local taxes or expenditures relating to those taxes; and

(4) Expenditures designated by the Internal Revenue Service by revenue ruling or revenue procedure, or, on a case-by-case basis, by letter ruling. (See § 601.601(d)(2)(ii)(b) of this chapter.)

(g) Exclusion of unlikely losses and deductions. Unlikely losses or deductions (other than items of

nonrecourse deduction) that may be specially allocated to partners that bear the economic burden of those losses or deductions are disregarded in computing overall partnership income or loss for purposes of the fractions rule, so long as a principal purpose of the allocation is not tax avoidance. To be excluded under this paragraph (g), a loss or deduction must have a low likelihood of occurring, taking into account all relevant facts, circumstances, and information available to the partners (including bona fide financial projections). The types of events that may give rise to unlikely losses or deductions, depending on the facts and circumstances, include tort and other third-party litigation that give rise to unforeseen liabilities in excess of reasonable insurance coverage; unanticipated labor strikes; unusual delays in securing required permits or licenses; abnormal weather conditions (considering the season and the job site); significant delays in leasing property due to an unanticipated severe economic downturn in the geographic area; unanticipated cost overruns; and the discovery of environmental conditions that require remediation. No inference is drawn as to whether a loss or deduction is unlikely from the fact that the partnership agreement includes a provision for allocating that loss or deduction.

(h) *Provisions preventing deficit capital account balances.* A provision in the partnership agreement that allocates items of loss or deduction away from a qualified organization in instances where allocating those items to the qualified organization would cause or increase a deficit balance in its capital account that the qualified organization is not obligated to restore (within the meaning of § 1.704-1(b)(2)(ii) (b) or (d)), is disregarded for purposes of the fractions rule in taxable years of the partnership in which no such allocations are made pursuant to the provision. However, this exception applies only if, at the time the provision becomes part of the partnership agreement, all relevant facts, circumstances, and information (including bona fide financial projections) available to the partners reasonably indicate that it is unlikely that an allocation will be made pursuant to the provision during the life of the partnership.

(i) [Reserved]

(j) *Exception for partner nonrecourse deductions.*—(1) *Partner nonrecourse deductions disregarded until actually allocated.* Items of partner nonrecourse deduction that may be allocated to a partner pursuant to § 1.704-2, and

compensating allocations of other items of loss, deduction, and section 705(a)(2)(B) expenditures that may be allocated to other partners, are not taken into account for purposes of the fractions rule until the taxable years in which they are allocated.

(2) *Disproportionate allocation of partner nonrecourse deductions to a qualified organization.* A violation of the fractions rule will be disregarded if it arises because an allocation of partner nonrecourse deductions to a qualified organization that is not motivated by tax avoidance reduces another qualified organization's fractions rule percentage below what it would have been absent the allocation of the partner nonrecourse deductions.

(k) *Special rules.*—(1) *Changes in partnership allocations arising from a change in the partners' interests.* A qualified organization that acquires a partnership interest from another qualified organization is treated as a continuation of the prior qualified organization partner (to the extent of that acquired interest) for purposes of applying the fractions rule. Changes in partnership allocations that result from other transfers or shifts of partnership interests will be closely scrutinized (to determine whether the transfer or shift stems from a prior agreement, understanding, or plan or could otherwise be expected given the structure of the transaction), but generally will be taken into account only in determining whether the partnership satisfies the fractions rule in the taxable year of the change and subsequent taxable years.

(2) *De minimis interest rule.*—(i) *In general.* Section 514(c)(9)(B)(vi) does not apply to a partnership otherwise subject to that section if—

(A) Qualified organizations do not hold, in the aggregate, interests of greater than five percent in the capital or profits of the partnership; and

(B) Taxable partners own substantial interests in the partnership through which they participate in the partnership on substantially the same terms as the qualified organization partners.

(ii) *Example.* Partnership PRS has two types of limited partnership interests that participate in partnership profits and losses on different terms. Qualified organizations (QOs) only own one type of limited partnership interest and own no general partnership interests. In the aggregate, the QOs own less than five percent of the capital and profits of PRS. Taxable partners also own the same type of limited partnership interest that the QOs own. These limited partnership interests owned by the taxable partners

are 30 percent of the capital and profits of PRS. Thirty percent is a substantial interest in the partnership. Therefore, PRS satisfies paragraph (k)(2) of this section and section 514(c)(9)(B)(vi) does not apply.

(3) *De minimis allocations disregarded.* A qualified organization's fractions rule percentage of the partnership's items of loss and deduction, other than nonrecourse and partner nonrecourse deductions, that are allocated away from the qualified organization and to other partners in any taxable year are treated as having been allocated to the qualified organization for purposes of the fractions rule if—

(i) The allocation was neither planned nor motivated by tax avoidance; and

(ii) The total amount of those items of partnership loss or deduction is less than both—

(A) One percent of the partnership's aggregate items of gross loss and deduction for the taxable year; and

(B) \$50,000.

(4) *Anti-abuse rule.* The purpose of the fractions rule is to prevent tax avoidance by limiting the permanent or temporary transfer of tax benefits from tax-exempt partners to taxable partners, whether by directing income or gain to tax-exempt partners, by directing losses, deductions, or credits to taxable partners, or by some other similar manner. This section may not be applied in a manner that is inconsistent with the purpose of the fractions rule.

(l) [Reserved]

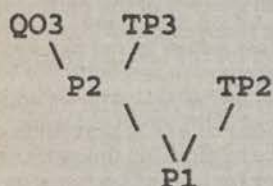
(m) *Tiered partnerships.*—(1) *In general.* If a qualified organization holds an indirect interest in real property through one or more tiers of partnerships (a chain), the fractions rule is satisfied only if—

(i) The avoidance of tax is not a principal purpose for using the tiered-ownership structure (investing in separate real properties through separate chains of partnerships so that section 514(c)(9)(E) is, effectively, applied on a property-by-property basis is not, in and of itself, a tax avoidance purpose); and

(ii) The relevant partnerships can demonstrate under any reasonable method that the relevant chains satisfy the requirements of paragraphs (b)(2) through (k) of this section. For purposes of applying § 1.704-2(k) under the independent chain approach described in Example 3 of paragraph (m)(2) of this section, allocations of items of income or gain that may be made pursuant to a provision in the partnership agreement that charges back minimum gain are taken into account for purposes of the fractions rule only to the extent an allocation is made.

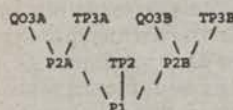
(2) *Examples.* The following examples illustrate the provisions of this paragraph (m).

Example 1. Tiered partnerships—collapsing approach. (i) Qualified organization QO3 and taxable individual TP3 form upper-tier partnership P2. The P2 partnership agreement allocates overall partnership income 20 percent to QO3 and 80 percent to TP3. Overall partnership loss is allocated 30 percent to QO3 and 70 percent to TP3. P2 and taxable individual TP2 form lower-tier partnership P1. The P1 partnership agreement allocates overall partnership income 60 percent to P2 and 40 percent to TP2. Overall partnership loss is allocated 40 percent to P2 and 60 percent to TP2. The only asset of P2 (which has no outstanding debt) is its interest in P1. P1 purchases real property with money contributed by its partners and with borrowed money. There is no tax avoidance purpose for the use of the tiered-ownership structure, which is illustrated by the following diagram.



(ii) P2 can demonstrate that the P2/P1 chain satisfies the requirements of paragraphs (b)(2) through (k) of this section by collapsing the tiered-partnership structure. On a collapsed basis, QO3's fractions rule percentage is 12 percent (30 percent of 40 percent). See paragraph (c)(2) of this section. P2 satisfies the fractions rule because QO3 may not be allocated more than 12 percent (20 percent of 60 percent) of overall partnership income in any taxable year.

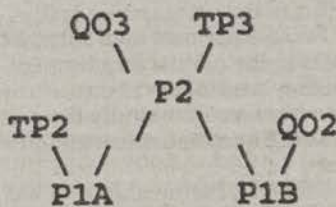
Example 2. Tiered partnerships—entity-by-entity approach. (i) Qualified organization QO3A is a partner with taxable individual TP3A in upper-tier partnership P2A. Qualified organization QO3B is a partner with taxable individual TP3B in upper-tier partnership P2B. P2A, P2B, and taxable individual TP2 are partners in lower-tier partnership P1, which owns encumbered real estate. None of QO3A, QO3B, TP3A, TP3B or TP2 has a direct or indirect ownership interest in each other. P2A has been established for the purpose of investing in numerous real estate properties independently of P2B and its partners. P2B has been established for the purpose of investing in numerous real estate properties independently of P2A and its partners. Neither P2A nor P2B has outstanding debt. There is no tax avoidance purpose for the use of the tiered-ownership structure, which is illustrated by the following diagram.



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(ii) The P2A/P1 chain (Chain A) will satisfy the fractions rule if P1 and P2A can demonstrate in a reasonable manner that they satisfy the requirements of paragraphs (b)(2) through (k) of this section. The P2B/P1 chain (Chain B) will satisfy the fractions rule if P1 and P2B can demonstrate in a reasonable manner that they satisfy the requirements of paragraphs (b)(2) through (k) of this section. To meet its burden, P1 treats P2A and P2B as qualified organizations. Provided that the allocations that may be made by P1 would satisfy the fractions rule if P2A and P2B were direct qualified organization partners in P1, Chain A will satisfy the fractions rule (for the benefit of QO3A) if the allocations that may be made by P2A satisfy the requirements of paragraphs (b)(2) through (k) of this section. Similarly, Chain B will satisfy the fractions rule (for the benefit of QO3B) if the allocations that may be made by P2B satisfy the requirements of paragraphs (b)(2) through (k) of this section. Under these facts, QO3A does not have to know how income and loss may be allocated by P2B, and QO3B does not have to know how income and loss may be allocated by P2A. QO3A's and QO3B's burden would not change even if TP2 were not a partner in P1.

Example 3. Tiered partnerships— independent chain approach. (i) Qualified organization QO3 and taxable corporation TP3 form upper-tier partnership P2. P2 and taxable corporation TP2 form lower-tier partnership P1A. P2 and qualified organization QO2 form lower-tier partnership P1B. P2 has no outstanding debt. P1A and P1B each purchase real property with money contributed by their respective partners and with borrowed money. Each partnership's real property is completely unrelated to the real property owned by the other partnership. P1B's allocations do not satisfy the requirements of paragraphs (b)(2) through (k) of this section because of allocations that may be made to QO2. However, if P2's interest in P1B were completely disregarded, the P2/P1A chain would satisfy the requirements of paragraphs (b)(2) through (k) of this section. There is no tax avoidance purpose for the use of the tiered-ownership structure, which is illustrated by the following diagram.



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(ii) P2 satisfies the fractions rule with respect to the P2/P1A chain, but only if the P2 partnership agreement allocates those items allocated to P2 by P1A separately from those items allocated to P2 by P1B. For this purpose, allocations of items of income or gain that may be made pursuant to a provision in the partnership agreement that charges back minimum gain, are taken into account for purposes of the fractions rule only to the extent an allocation is made. See

paragraph (m)(1)(ii) of this section. P2 does not satisfy the fractions rule with respect to the P2/P1B chain.

(n) *Effective date—(1) In general.* Section 514(c)(9)(E), as amended by sections 2004(h) (1) and (2) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, applies generally with respect to property acquired by partnerships after October 13, 1987, and to partnership interests acquired after October 13, 1987.

(2) *General effective date of the regulations.* Section 1.514(c)-2 (a) through (m) applies with respect to partnership agreements entered into after December 30, 1992, property acquired by partnerships after December 30, 1992, and partnership interests acquired by qualified organizations after December 30, 1992 (other than a partnership interest that at all times after October 13, 1987, and prior to the acquisition was held by a qualified organization). For this purpose, paragraphs (a) through (m) of this section will be treated as satisfied with respect to partnership agreements entered into on or before May 13, 1994, property acquired by partnerships on or before May 13, 1994, and partnership interests acquired by qualified organizations on or before May 13, 1994, if the guidance set forth in (paragraphs (a) through (m) of § 1.514(c)-2 of PS-56-90, published at 1993-5 I.R.B. 42, February 1, 1993, is satisfied. (See § 601.601(d)(2)(ii)(b) of this chapter).

(3) *Periods after June 24, 1990, and prior to December 30, 1992.* To satisfy the requirements of section 514(c)(9)(E) with respect to partnership agreements entered into after June 24, 1990, property acquired by partnerships after June 24, 1990, and partnership interests acquired by qualified organizations after June 24, 1990, (other than a partnership interest that at all times after October 13, 1987, and prior to the acquisition was held by a qualified organization) to which paragraph (n)(2) of this section does not apply, paragraphs (a) through (m) of this section must be satisfied as of the first day that section 514(c)(9)(E) applies with respect to the partnership, property, or acquired interest. For this purpose, paragraphs (a) through (m) of this section will be treated as satisfied if the guidance in sections I through VI of Notice 90-41, 90-1 C.B. 350, (see § 601.601(d)(2)(ii)(b) of this chapter) has been followed.

(4) *Periods prior to the issuance of Notice 90-41.* With respect to partnerships commencing after October 13, 1987, property acquired by partnerships after October 13, 1987, and partnership interests acquired by qualified organizations after October 13,

1987, to which neither paragraph (n)(2) nor (n)(3) of this section applies, the Internal Revenue Service will not challenge an interpretation of section 514(c)(9)(E) that is reasonable in light of the underlying purposes of section 514(c)(9)(E) (as reflected in its legislative history) and that is consistently applied as of the first day that section 514(c)(9)(E) applies with respect to the partnership, property, or acquired interest. A reasonable interpretation includes an interpretation that substantially follows the guidance in either sections I through VI of Notice 90-41, (see § 601.601(d)(2)(ii)(b) of this chapter) or paragraphs (a) through (m) of this section.

(5) Material modifications to partnership agreements. A material modification will cause a partnership agreement to be treated as a new partnership agreement in appropriate circumstances for purposes of this paragraph (n).

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: April 21, 1994.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 94-11612 Filed 5-11-94; 8:45 am]

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26 CFR Parts 1 and 602

[TD 8537]

RIN 1545-AQ50

Carryover of Passive Activity Losses and Credits and At Risk Losses to Bankruptcy Estates of Individuals

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of carryover of passive activity losses and credits and at risk losses to the bankruptcy estates of individuals. The final regulations affect individual taxpayers who file bankruptcy petitions under chapter 7 or chapter 11 of title 11 of the United States Code and have passive activity losses and credits under section 469 or losses under section 465.

DATES: These regulations are effective May 13, 1994.

These regulations apply to bankruptcy cases commencing on or after November 9, 1992. In addition, the regulations apply, at the election of the affected taxpayers, to cases that commenced before, and end on or after, November 9, 1992.

FOR FURTHER INFORMATION CONTACT:

Amy J. Sargent of the Office of Assistant Chief Counsel (Income Tax & Accounting), Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or telephone (202) 622-4930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

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 requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1375. The estimated annual burden per respondent varies from .5 hour to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Background

This document contains final Income Tax Regulations (26 CFR part 1) under section 1398 of the Internal Revenue Code (Code). On November 9, 1992, the IRS published in the Federal Register a notice of proposed rulemaking designating passive activity losses and credits under section 469 and unused section 465 losses as attributes that pass from the debtor to the bankruptcy estate under section 1398(g) of the Code and that, upon termination of the estate, pass from the bankruptcy estate to the debtor under section 1398(i). Corrections to the Notice of Proposed Rulemaking were published in the Federal Register on December 22, 1992 (57 FR 246). A public hearing was held on January 25, 1993. After consideration of the public comments regarding the proposed regulations, the final regulations adopt the rules contained in the proposed regulations without substantive change. A discussion of the public comments is set forth below.

Public Comments

The comments received by the IRS were generally favorable, welcoming the designation of attributes under section 1398(g)(8). Several commentators suggested that the regulations be

modified. These suggestions are discussed below.

I. Expansion of the Proposed Regulations to Include Additional Attributes

The proposed regulations designate passive activity losses and credits under section 469 and losses under section 465 as attributes that pass from the debtor to the estate. Several commentators suggested that the scope of the proposed regulations be expanded to include additional attributes of the debtor, either by specifically listing the additional attributes or by providing that attributes of the debtor pass to the estate if they are related to property passing to the estate or are in the nature of a carryforward.

These suggestions were not adopted in the final regulations. The treatment of other unenumerated attributes under section 1398 (g) and (i) is more appropriately provided in a separate regulation project. This would provide taxpayers with an opportunity to comment before additional attributes of the debtor are designated, by final regulation, as attributes that pass to the estate.

II. Taxation of Estate's Transfers of an Interest in a Passive Activity or Former Passive Activity or an Interest in a Section 465 Activity Before Termination of the Estate

The proposed regulations provide that if, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange), the transfer is not treated as a disposition for purposes of any provision of the Code assigning tax consequences to a disposition. By way of example, the proposed regulations state that such transfers include transfers from the estate to the debtor of property that is exempt under section 522 of title 11 of the United States Code and abandonments of estate property to the debtor under section 554(a) of such title. The proposed regulations provide similar rules for the transfer of a section 465 activity.

Several commentators objected on the grounds that these provisions are outside the scope of the regulatory authority of the IRS under section 1398(g) and (i). In general, these commentators maintained that the regulatory authority of the IRS is limited to listing attributes that pass from the debtor to the estate and that, upon termination of the estate, pass to the debtor. In addition, one commentator contended that the provisions relating to pre-termination transfers between the

estate and the debtor constitute an improper attempt to amend by regulation the express language of section 1398(f)(2). Commentators also questioned the treatment of abandonments as nontaxable dispositions, reiterating many of the arguments set forth in *In re A.J. Lane & Co.*, 133 B.R. 264 (Bankr. D. Mass. 1991), which stated in *dicta* that abandonments are taxable dispositions. See also *In re Rubin*, 154 B.R. 897 (Bankr. D. Md. 1992).

The final regulations retain the rules of the proposed regulations. Although section 1398 does not provide explicit rules relating to pre-termination transfers between the estate and the debtor, the Secretary has authority pursuant to section 7805(a) to issue interpretative regulations under section 1398. The IRS and the Treasury Department believe the rules adopted in the final regulations are consistent with the overall system established by section 1398 and, in the absence of a contrary statutory provision, are a reasonable exercise of the Secretary's authority under section 7805(a). Moreover, the rules adopted in the final regulations are consistent with the only appellate court case on point, which holds that the transfer (other than by sale or exchange) of an asset from the estate to the debtor before the termination of the estate is a nontaxable disposition. See *In re Olson*, 100 B.R. 458 (Bankr. N.D. Iowa 1989), *aff'd*, 121 B.R. 346 (N.D. Iowa 1990), *aff'd*, 930 F.2d 6 (8th Cir. 1991).

III. Debtor's Succession to the Estate's Passive Activity Losses and Credits and Unused Section 465 Losses Before Termination of the Estate

As a corollary to the treatment of the estate's transfer of an interest in a passive activity or former passive activity as a nontaxable disposition, the proposed regulations provide that if, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange), the debtor succeeds to and takes into account the allocable portion of the estate's unused passive activity loss and credit attributable to the activity (determined as of the first day of the estate's taxable year in which the transfer occurs). The proposed regulations provide similar rules for section 465 losses.

The objections submitted by one commentator generally parallel the previously discussed objections to the treatment of the estate's transfer of an interest in a passive activity or former passive activity before the termination

of the estate as a nontaxable disposition. The final regulations retain the rules in the proposed regulations.

IV. Effective Date

The provisions of §§ 1.1398-1 and 1.1398-2 were proposed to be effective for bankruptcy cases commencing on or after November 9, 1992. Several commentators suggested alternative effective dates for the final regulations. One commentator recommended that a more appropriate effective date would be the date the regulations become final. Another commentator contended that, at least in certain situations, the regulations should be effective for bankruptcy cases commencing prior to November 9, 1992.

The IRS and the Treasury Department believe that it is not necessary to delay the effective date because publication of the proposed regulations, which are being finalized without significant change, provided adequate notice of the new rules. In addition, limiting the application of the new rules to cases commenced after publication of the proposed regulations is clearly within the Treasury Department's authority to prescribe the extent to which regulations shall be applied without retroactive effect and conforms to the pattern of section 1398(g), which applies to cases commencing after March 25, 1981. Accordingly, the final regulations retain the effective date of the proposed regulations.

V. Joint Election to Have §§ 1.1398-1 and 1.1398-2 Apply to Cases Commenced Before November 9, 1992

For cases commenced prior to November 9, 1992, and terminating on or after that date, the proposed regulations apply only if a joint election is made by the debtor and the estate. In cases under chapter 7, the election is valid only with the written consent of the bankruptcy trustee. In cases under chapter 11, the election is valid only if it is incorporated (a) into a bankruptcy plan that is confirmed by the bankruptcy court, or (b) into an order of the court. Additionally, the caption "ELECTION PURSUANT TO § 1.1398-1 (or § 1.1398-2)" must be placed prominently on the first page of each of the debtor's returns that is affected by the election (other than returns for taxable years that begin after the termination of the estate) and on the first page of each of the estate's returns that is affected by the election.

One commentator recommended eliminating the requirement that the debtor join in the election. In general, this commentator felt that this requirement gave the debtor exclusive

control over the passive activity losses and credits and unused section 465 losses to the detriment of the creditors.

The final regulations retain the requirement that the debtor join in the election. This requirement permits debtors to rely on the law in effect at the time they entered into bankruptcy.

One commentator suggested that because the consent of the debtor is required, the regulations should clarify that the written consent of the debtor is required in cases under chapter 7, in addition to the written consent of a bankruptcy trustee. The proposed regulations require the debtor to show consent by actually making the election. The debtor's election will be evidenced by the return on which it is made, and it is not clear what purpose would be served by an additional paperwork requirement. Accordingly, this suggestion was not adopted.

A commentator requested clarification as to whether the election could be made on an amended return. In response to this comment, the regulations clarify that the election can be made on an amended return.

Finally, a commentator requested that the regulations clarify whether the election is available for estates that are terminated after November 9, 1992, but before the adoption of final regulations. Because the regulations are sufficiently clear on this point, this comment was not adopted.

VI. Other Comments

One commentator requested that the regulations provide guidance on the determination of basis under section 1398(g)(6), which provides that, in the case of assets acquired by the estate from the debtor, the estate succeeds to the debtor's basis, determined as of the first day of the debtor's taxable year in which the case commenced. The specific guidance requested concerned the effect on basis of events (such as depreciation or distributions received by the debtor as the result of holding an interest in a passthrough entity) that occur after the first day of the debtor's taxable year in which the case commenced, but prior to the commencement date. It was also requested that the regulations provide guidance on the application of the "varying interest" rule of section 706(d)(1) to the estate. This guidance is outside the scope of these regulations. Accordingly, the final regulations do not provide guidance on these issues.

Special Analysis

It has been determined that these final regulations are not significant rules as defined in EO 12866. Therefore, a

regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of the proposed rules 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 Amy J. Sargent of the Office of Assistant Chief Counsel (Income Tax and Accounting), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are 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. An undesignated center heading is added immediately following § 1.1388-1 to read as follows:
"Rules Relating to Individuals' Title 11 Cases"

Par. 3. Sections 1.1398-1 and 1.1398-2 are added to read as follows:

§ 1.1398-1 Treatment of passive activity losses and passive activity credits in individuals' title 11 cases.

(a) *Scope.* This section applies to cases under chapter 7 or chapter 11 of title 11 of the United States Code, but only if the debtor is an individual.

(b) *Definitions and rules of general application.* For purposes of this section—

(1) *Passive activity and former passive activity* have the meanings given in section 469(c) and (f)(3);

(2) The unused passive activity loss (determined as of the first day of a taxable year) is the passive activity loss

(as defined in section 469(d)(1)) that is disallowed under section 469 for the previous taxable year; and

(3) The unused passive activity credit (determined as of the first day of a taxable year) is the passive activity credit (as defined in section 469(d)(2)) that is disallowed under section 469 for the previous taxable year.

(c) *Estate succeeds to losses and credits upon commencement of case.* The bankruptcy estate (estate) succeeds to and takes into account, beginning with its first taxable year, the debtor's unused passive activity loss and unused passive activity credit (determined as of the first day of the debtor's taxable year in which the case commences).

(d) *Transfers from estate to debtor—*

(1) *Transfer not treated as taxable event.* If, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange), the transfer is not treated as a disposition for purposes of any provision of the Internal Revenue Code assigning tax consequences to a disposition. The transfers to which this rule applies include transfers from the estate to the debtor of property that is exempt under section 522 of title 11 of the United States Code and abandonments of estate property to the debtor under section 554(a) of such title.

(2) *Treatment of passive activity loss and credit.* If, before the termination of the estate, the estate transfers an interest in a passive activity or former passive activity to the debtor (other than by sale or exchange)—

(i) The estate must allocate to the transferred interest, in accordance with § 1.469-1(f)(4), part or all of the estate's unused passive activity loss and unused passive activity credit (determined as of the first day of the estate's taxable year in which the transfer occurs); and

(ii) The debtor succeeds to and takes into account, beginning with the debtor's taxable year in which the transfer occurs, the unused passive activity loss and unused passive activity credit (or part thereof) allocated to the transferred interest.

(e) *Debtor succeeds to loss and credit of the estate upon its termination.* Upon termination of the estate, the debtor succeeds to and takes into account, beginning with the debtor's taxable year in which the termination occurs, the passive activity loss and passive activity credit disallowed under section 469 for the estate's last taxable year.

(f) *Effective date—*(1) *Cases commencing on or after November 9, 1992.* This section applies to cases commencing on or after November 9, 1992.

(2) *Cases commencing before November 9, 1992—*(i) *Election required.* This section applies to a case commencing before November 9, 1992, and terminating on or after that date if the debtor and the estate jointly elect its application in the manner prescribed in paragraph (f)(2)(v) of this section (the election). The caption "ELECTION PURSUANT TO § 1.1398-1" must be placed prominently on the first page of each of the debtor's returns that is affected by the election (other than returns for taxable years that begin after the termination of the estate) and on the first page of each of the estate's returns that is affected by the election. In the case of returns that are amended under paragraph (f)(2)(iii) of this section, this requirement is satisfied by placing the caption on the amended return.

(ii) *Scope of election.* This election applies to the passive and former passive activities and unused passive activity losses and passive activity credits of the taxpayers making the election.

(iii) *Amendment of previously filed returns.* The debtor and the estate making the election must amend all returns (except to the extent they are for a year that is a closed year within the meaning of paragraph (f)(2)(iv)(D) of this section) they filed before the date of the election to the extent necessary to provide that no claim of a deduction or credit is inconsistent with the succession under this section to unused losses and credits. The Commissioner may revoke or limit the effect of the election if either the debtor or the estate fails to satisfy the requirement of this paragraph (f)(2)(iii).

(iv) *Rules relating to closed years—*(A) *Estate succeeds to debtor's passive activity loss and credit as of the commencement date.* If, by reason of an election under this paragraph (f), this section applies to a case that was commenced in a closed year, the estate, nevertheless, succeeds to and takes into account the unused passive activity loss and unused passive activity credit of the debtor (determined as of the first day of the debtor's taxable year in which the case commenced).

(B) *No reduction of unused passive activity loss and credit for passive activity loss and credit not claimed for a closed year.* In determining a taxpayer's carryover of a passive activity loss or credit to its taxable year following a closed year, a deduction or credit that the taxpayer failed to claim in the closed year, if attributable to an unused passive activity loss or credit to which the taxpayer succeeded under this section, is treated as a deduction or

credit that was disallowed under section 469.

(C) *Passive activity loss and credit to which taxpayer succeeds reflects deductions of prior holder in a closed year.* A loss or credit to which a taxpayer would otherwise succeed under this section is reduced to the extent the loss or credit was allowed to its prior holder for a closed year.

(D) *Closed year.* For purposes of this paragraph (f)(2)(iv), a taxable year is closed to the extent the assessment of a deficiency or refund of an overpayment is prevented, on the date of the election and at all times thereafter, by any law or rule of law.

(v) *Manner of making election—(A) Chapter 7 cases.* In a case under chapter 7 of title 11 of the United States Code, the election is made by obtaining the written consent of the bankruptcy trustee and filing a copy of the written consent with the returns (or amended returns) of the debtor and the estate for their first taxable years ending after November 9, 1992.

(B) *Chapter 11 cases.* In a case under chapter 11 of title 11 of the United States Code, the election is made by incorporating the election into a bankruptcy plan that is confirmed by the bankruptcy court or into an order of such court and filing the pertinent portion of the plan or order with the returns (or amended returns) of the debtor and the estate for their first taxable years ending after November 9, 1992.

(vi) *Election is binding and irrevocable.* Except as provided in paragraph (f)(2)(iii) of this section, the election, once made, is binding on both the debtor and the estate and is irrevocable.

§ 1.1398-2 Treatment of section 465 losses in individuals' title 11 cases.

(a) *Scope.* This section applies to cases under chapter 7 or chapter 11 of title 11 of the United States Code, but only if the debtor is an individual.

(b) *Definition and rules of general application.* For purposes of this section—

(1) *Section 465 activity* means an activity to which section 465 applies; and

(2) For each section 465 activity, the unused section 465 loss from the activity (determined as of the first day of a taxable year) is the loss (as defined in section 465(d)) that is not allowed under section 465(a)(1) for the previous taxable year.

(c) *Estate succeeds to losses upon commencement of case.* The bankruptcy estate (the estate) succeeds to and takes into account, beginning with its first

taxable year, the debtor's unused section 465 losses (determined as of the first day of the debtor's taxable year in which the case commences).

(d) *Transfers from estate to debtor—*

(1) *Transfer not treated as taxable event.* If, before the termination of the estate, the estate transfers an interest in a section 465 activity to the debtor (other than by sale or exchange), the transfer is not treated as a disposition for purposes of any provision of the Internal Revenue Code assigning tax consequences to a disposition. The transfers to which this rule applies include transfers from the estate to the debtor of property that is exempt under section 522 of title 11 of the United States Code and abandonments of estate property to the debtor under section 554(a) of such title.

(2) *Treatment of section 465 losses.* If, before the termination of the estate, the estate transfers an interest in a section 465 activity to the debtor (other than by sale or exchange) the debtor succeeds to and takes into account, beginning with the debtor's taxable year in which the transfer occurs, the transferred interest's share of the estate's unused section 465 loss from the activity (determined as of the first day of the estate's taxable year in which the transfer occurs). For this purpose, the transferred interest's share of such loss is the amount, if any, by which such loss would be reduced if the transfer had occurred as of the close of the preceding taxable year of the estate and been treated as a disposition on which gain or loss is recognized.

(e) *Debtor succeeds to losses of the estate upon its termination.* Upon termination of the estate, the debtor succeeds to and takes into account, beginning with the debtor's taxable year in which the termination occurs, the losses not allowed under section 465 for the estate's last taxable year.

(f) *Effective date—(1) Cases commencing on or after November 9, 1992.* This section applies to cases commencing on or after November 9, 1992.

(2) *Cases commencing before November 9, 1992—(i) Election required.* This section applies to a case commencing before November 9, 1992, and terminating on or after that date if the debtor and the estate jointly elect its application in the manner prescribed in paragraph (f)(2)(v) of this section (the election). The caption "ELECTION PURSUANT TO § 1.1398-2" must be placed prominently on the first page of each of the debtor's returns that is affected by the election (other than returns for taxable years that begin after the termination of the estate) and on the first page of each of the estate's returns

that is affected by the election. In the case of returns that are amended under paragraph (f)(2)(iii) of this section, this requirement is satisfied by placing the caption on the amended return.

(ii) *Scope of election.* This election applies to the section 465 activities and unused losses from section 465 activities of the taxpayers making the election.

(iii) *Amendment of previously filed returns.* The debtor and the estate making the election must amend all returns (except to the extent they are for a year that is a closed year within the meaning of paragraph (f)(2)(iv)(D) of this section) they filed before the date of the election to the extent necessary to provide that no claim of a deduction is inconsistent with the succession under this section to unused losses from section 465 activities. The Commissioner may revoke or limit the effect of the election if either the debtor or the estate fails to satisfy the requirement of this paragraph (f)(2)(iii).

(iv) *Rules relating to closed years—(A) Estate succeeds to debtor's section 465 loss as of the commencement date.* If, by reason of an election under this paragraph (f), this section applies to a case that was commenced in a closed year, the estate, nevertheless, succeeds to and takes into account the section 465 losses of the debtor (determined as of the first day of the debtor's taxable year in which the case commenced).

(B) *No reduction of unused section 465 loss for loss not claimed for a closed year.* In determining a taxpayer's carryover of an unused section 465 loss to its taxable year following a closed year, a deduction that the taxpayer failed to claim in the closed year, if attributable to an unused section 465 loss to which the taxpayer succeeds under this section, is treated as a deduction that was not allowed under section 465.

(C) *Loss to which taxpayer succeeds reflects deductions of prior holder in a closed year.* A loss to which a taxpayer would otherwise succeed under this section is reduced to the extent the loss was allowed to its prior holder for a closed year.

(D) *Closed year.* For purposes of this paragraph (f)(2)(iv), a taxable year is closed to the extent the assessment of a deficiency or refund of an overpayment is prevented, on the date of the election and at all times thereafter, by any law or rule of law.

(v) *Manner of making election—(A) Chapter 7 cases.* In a case under chapter 7 of title 11 of the United States Code, the election is made by obtaining the written consent of the bankruptcy trustee and filing a copy of the written

consent with the returns (or amended returns) of the debtor and the estate for their first taxable years ending after November 9, 1992.

(B) *Chapter 11 cases.* In a case under chapter 11 of title 11 of the United States Code, the election is made by incorporating the election into a bankruptcy plan that is confirmed by the bankruptcy court or into an order of such court and filing the pertinent portion of the plan or order with the returns (or amended returns) of the debtor and the estate for their first taxable years ending after November 9, 1992.

(vi) *Election is binding and irrevocable.* Except as provided in paragraph (f)(2)(iii) of this section, the election, once made, is binding on both the debtor and the estate and is irrevocable.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In § 602.101(c), entries are added to the table in numerical order to read as follows:

CFR part or section where identified and described	Current OMB control No.
1.1398-1	1545-1375
1.1398-2	1545-1375
.....	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: April 6, 1994.

Leslie Samuels,
Assistant Secretary of the Treasury.

[FR Doc. 94-11493 Filed 05-12-94; 8:45 am]
BILLING CODE 4830-01-U

PENSION BENEFIT GUARANTY CORPORATION

29 CFR Parts 2619 and 2676

Valuation of Plan Benefits in Single-Employer Plans; Valuation of Plan Benefits and Plan Assets Following Mass Withdrawal; Amendments Adopting Additional PBGC Rates

AGENCY: Pension Benefit Guaranty Corporation.

ACTION: Final rule.

SUMMARY: This final rule amends the Pension Benefit Guaranty Corporation's

("PBGC's") regulations on Valuation of Plan Benefits in Single-Employer Plans and Valuation of Plan Benefits and Plan Assets Following Mass Withdrawal. The former regulation contains the interest assumptions that the PBGC uses to value benefits under terminating single-employer plans. The latter regulation contains the interest assumptions for valuations of multiemployer plans that have undergone mass withdrawal. The amendments set out in this final rule adopt the interest assumptions applicable to single-employer plans with termination dates in June 1994, and to multiemployer plans with valuation dates in June 1994. The effect of these amendments is to advise the public of the adoption of these assumptions.

EFFECTIVE DATE: June 1, 1994.

FOR FURTHER INFORMATION CONTACT: Harold J. Ashner, Assistant General Counsel, Office of the General Counsel, Pension Benefit Guaranty Corporation, 1200 K Street, NW., Washington, DC 20005, 202-326-4024 (202-326-4179 for TTY and TDD). (These are not toll-free numbers.)

SUPPLEMENTARY INFORMATION: This rule adopts the June 1994 interest assumptions to be used under the Pension Benefit Guaranty Corporation's ("PBGC's") regulations on Valuation of Plan Benefits in Single-Employer Plans (29 CFR part 2619, the "single-employer regulation") and Valuation of Plan Benefits and Plan Assets Following Mass Withdrawal (29 CFR part 2676, the "multiemployer regulation").

Part 2619 sets forth the methods for valuing plan benefits of terminating single-employer plans covered under title IV of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Under ERISA section 4041(c), all single-employer plans wishing to terminate in a distress termination must value guaranteed benefits and "benefit liabilities," i.e., all benefits provided under the plan as of the plan termination date, using the formulas set forth in part 2619, subpart C. (Plans terminating in a standard termination may, for purposes of the Standard Termination Notice filed with PBGC, use these formulas to value benefit liabilities, although this is not required.) In addition, when the PBGC terminates an underfunded plan involuntarily pursuant to ERISA section 4042(a), it uses the subpart C formulas to determine the amount of the plan's underfunding. Part 2676 prescribes rules for valuing benefits and certain assets of multiemployer plans under sections 4219(c)(1)(D) and 4281(b) of ERISA.

Appendix B to part 2619 sets forth the interest rates and factors under the single-employer regulation. Appendix B to part 2676 sets forth the interest rates and factors under the multiemployer regulation. Because these rates and factors are intended to reflect current conditions in the financial and annuity markets, it is necessary to update the rates and factors periodically.

The PBGC issues two sets of interest rates and factors, one set to be used for the valuation of benefits to be paid as annuities and one set for the valuation of benefits to be paid as lump sums. The same assumptions apply to terminating single-employer plans and to multiemployer plans that have undergone a mass withdrawal. This amendment adds to appendix B to parts 2619 and 2676 sets of interest rates and factors for valuing benefits in a single-employer plans that have termination dates during June 1994 and multiemployer plans that have undergone mass withdrawal and have valuation dates during June 1994.

For annuity benefits, the interest rates will be 6.70% for the first 25 years following the valuation date and 5.25% thereafter. For benefits to be paid as lump sums, the interest assumptions to be used by the PBGC will be 5.25% for the period during which benefits are in pay status, 4.5% during the seven years directly preceding the benefit's placement in pay status, and 4.0% during any other years preceding the benefit's placement in pay status. (ERISA section 205(g) and Internal Revenue Code section 417(e) provide that private sector plans valuing lump sums not in excess of \$25,000 must use interest assumptions at least as generous as those used by the PBGC for valuing lump sums (and for lump sums exceeding \$25,000 must use interest assumptions at least as generous as 120% of the PBGC interest assumptions).) The above annuity interest assumptions represent an increase (from those in effect for May 1994) of .20 percent for the first 25 years following the valuation date and are otherwise unchanged. The lump sum interest assumptions are unchanged from those in effect for May 1994.

Generally, the interest rates and factors under these regulations are in effect for at least one month. However, the PBGC publishes its interest assumptions each month regardless of whether they represent a change from the previous month's assumptions. The assumptions normally will be published in the *Federal Register* by the 15th of the preceding month or as close to that date as circumstances permit.

The PBGC has determined that notice and public comment on these amendments are impracticable and contrary to the public interest. This finding is based on the need to determine and issue new interest rates and factors promptly so that the rates and factors can reflect, as accurately as possible, current market conditions.

Because of the need to provide immediate guidance for the valuation of benefits in single-employer plans whose termination dates fall during June 1994, and in multiemployer plans that have undergone mass withdrawal and have valuation dates during June 1994, the PBGC finds that good cause exists for making the rates and factors set forth in this amendment effective less than 30 days after publication.

The PBGC has determined that this action is not a "significant regulatory action" under the criteria set forth in Executive Order 12866, because it will not have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or raise novel legal or policy issues arising out of legal mandates, the

President's priorities, or the principles set forth in Executive Order 12866.

Because no general notice of proposed rulemaking is required for this amendment, the Regulatory Flexibility Act of 1980 does not apply. See 5 U.S.C. 601(2).

List of Subjects

29 CFR Part 2619

Employee benefit plans, Pension insurance, and Pensions.

29 CFR Part 2676

Employee benefit plans and Pensions.

In consideration of the foregoing, parts 2619 and 2676 of chapter XXVI, title 29, Code of Federal Regulations, are hereby amended as follows:

PART 2619—[AMENDED]

1. The authority citation for part 2619 continues to read as follows:

Authority: 29 U.S.C. 1301(a), 1302(b)(3), 1341, 1344, 1362.

2. In appendix B, Rate Set 8 is added to Table I, and a new entry is added to Table II, as set forth below. The introductory text of both tables is republished for the convenience of the reader and remains unchanged.

Appendix B to Part 2619—Interest Rates Used to Value Lump Sums and Annuities

Lump Sum Valuations

In determining the value of interest factors of the form v^n (as defined in

§ 2619.49(b)(1)) for purposes of applying the formulas set forth in § 2619.49(b) through (i) and in determining the value of any interest factor used in valuing benefits under this subpart to be paid as lump sums (including the return of accumulated employee contributions upon death), the PBGC shall employ the values of i_t set out in Table I hereof as follows:

(1) For benefits for which the participant or beneficiary is entitled to be in a pay status on the valuation date, the immediate annuity rate shall apply.

(2) For benefits for which the deferral period is y years (Y is an integer and $0 < y \leq n_1$), interest rate i_1 shall apply from the valuation date for a period of y years, thereafter the immediate annuity rate shall apply.

(3) For benefits for which the deferral period is y years (y is an integer and $n_1 < y \leq n_1 + n_2$), interest rate i_2 shall apply from the valuation date for a period of $y - n_1$ years, interest rate i_1 shall apply for the following n_1 years; thereafter the immediate annuity rate shall apply.

(4) For benefits for which the deferral period is y years (y is an integer and $y > n_1 + n_2$), interest rate i_3 shall apply from the valuation date for a period of $y - n_1 - n_2$ years, interest rate i_2 shall apply for the following n_2 years, interest rate i_1 shall apply for the following n_1 years; thereafter the immediate annuity rate shall apply.

TABLE I
[Lump Sum Valuations]

Rate set	For plans with a valuation date		Immediate annuity rate (percent)	Deferred annuities (percent)				
	On or after	Before		i_1	i_2	i_3	n_1	n_2
8	6-1-94	7-1-94	5.25	4.50	4.00	4.00	7	8

Annuity Valuations

In determining the value of interest factors of the form v^n (as defined in § 2619.49 (b)(1)) for purposes of applying the formulas set forth in § 2619.49 (b) through (i) and in determining the value of any interest

factor used in valuing annuity benefits under this subpart, the plan administrator shall use the values of i_t prescribed in Table II hereof.

The following table tabulates, for each calendar month of valuation ending after the effective date of this part, the interest rates (denoted by $i_1, i_2, \dots$, and

referred to generally as i_t) assumed to be in effect between specified anniversaries of a valuation date that occurs within that calendar month; those anniversaries are specified in the columns adjacent to the rates. The last listed rate is assumed to be in effect after the last listed anniversary date.

TABLE II
[Annuity Valuations]

For valuation dates occurring in the month—	The values of i_t are:					
	i_t	for $t=$	i_t	for $t=$	i_t	for $t=$
June 1994	.0670	1-25	.0525	>25	N/A	N/A

PART 2676—[AMENDED]

3. The authority citation for part 2676 continues to read as follows:

Authority: 29 U.S.C. 1302(b)(3), 1399 (c)(1) (D), 1441(b)(1).

4. In appendix B, Rate Set 8 is added to Table I, and a new entry is added to Table II, as set forth below. The introductory text of both tables is republished for the convenience of the reader and remains unchanged.

Appendix B to Part 2676—Interest Rates Used to Value Lump Sums and Annuities

Lump Sum Valuations

In determining the value of interest factors of the form V^n (as defined in

§ 2676.13 (b) (1)) for purposes of applying the formulas set forth in § 2677.13(b) through (i) and in determining the value of any interest factor used in valuing benefits under this subpart to be paid as lump sums, the PBGC shall use the values of i_t prescribed in Table I hereof. The interest rates set forth in Table I shall be used by the PBGC to calculate benefits payable as lump sum benefits as follows:

(1) For benefits for which the participant or beneficiary is entitled to be in pay status on the valuation date, the immediate annuity rate shall apply.

(2) For benefits for which the deferral period is y years (y is an integer and $0 < y \leq n_1$), interest rate i_t shall apply from

the valuation date for a period of y years; thereafter the immediate annuity rate shall apply.

(3) For benefits for which the deferral period is y years (y is an integer and $n_1 < y \leq n_1 + n_2$), interest rate i_2 shall apply from the valuation date for a period of $y - n_1$ years, interest rate i_1 shall apply for the following n_1 years; thereafter the immediate annuity rate shall apply.

(4) For benefits for which the deferral period is y years (y is an integer and $y > n_1 + n_2$), interest rate i_3 shall apply from the valuation date for a period of $y - n_1 - n_2$ years, interest rate i_2 shall apply for the following n_2 years, interest rate i_1 shall apply for the following n_1 years; thereafter the immediate annuity rate shall apply.

TABLE I
[Lump Sum Valuations]

Rate set	For plans with a valuation date		Immediate annuity rate (percent)	Deferred annuities (percent)				
	On or after	Before		i_1	i_2	i_3	n_1	n_2
8	6-1-94	7-1-94	5.25	4.50	4.00	4.00	7	8

Annuity Valuations

In determining the value of interest factors of the form V^n (as defined in § 2676.13(b)(1)) for purposes of applying the formulas set forth in § 2676.13(b) through (i) and in determining the value of any interest factor used in valuing

annuity benefits under this subpart, the plan administrator shall use the values of i_t prescribed in the table below.

The following table tabulates, for each calendar month of valuation ending after the effective date of this part, the interest rates (denoted by $i_1, i_2, \dots$, and

referred to generally as i_t) assumed to be in effect between specified anniversaries of a valuation date that occurs within that calendar month; those anniversaries are specified in the columns adjacent to the rates. The last listed rate is assumed to be in effect after the last listed anniversary date.

TABLE II
[Annuity Valuations]

For valuation dates occurring in the month—	The values of i_t are:					
	i_t	for $t=$	i_t	for $t=$	i_t	for $t=$
June 1994	.0670	1-25	.0525	>25	N/A	N/A

Issued in Washington, DC, on this 11th day of May 1994.

Martin Slate,

Executive Director, Pension Benefit Guaranty Corporation.

[FR Doc. 94-11826 Filed 5-12-94; 8:45 am]

BILLING CODE 7708-01-M

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Part 100

[CGD 05-94-012]

Special Local Regulations for Marine Events; The Great Chesapeake Bay Swim Event, Chesapeake Bay, MD

AGENCY: Coast Guard, DOT.

ACTION: Notice of implementation.

SUMMARY: This notice implements special local regulations for the Great Chesapeake Bay Swim Event to be held on June 12, 1994. These special local regulations are needed to provide for the safety of participants and spectators on the navigable waters during this event. The effect will be to restrict general navigation in the regulated area for the safety of participants in the swim, and their attending personnel.

EFFECTIVE DATES: This regulation is effective from 6:30 a.m. until 1 p.m., on June 12, 1994.

FOR FURTHER INFORMATION CONTACT: Stephen L. Phillips, Chief, Boating Affairs Branch, Fifth Coast Guard District, 431 Crawford Street, Portsmouth, Virginia 23704-5004 (804) 398-6204, or Commander, Coast Guard Group Baltimore (410) 576-8516.

DRAFTING INFORMATION: The drafters of this notice are QM2 Gregory C. Garrison, project officer, Boating Affairs Branch, Boating Safety Division, Fifth Coast Guard District, and LT John B. Gately, project attorney, Fifth Coast Guard District Legal Staff.

Discussion:

Mr. Charles Nabit, a representative of the March of Dimes, submitted an application on November 23, 1993 to hold the Great Chesapeake Bay Swim Event on June 12, 1994. Approximately 600 swimmers will start from Sandy Point State Park and swim between the William P. Lane Jr. Memorial Twin Bridges to the Eastern Shore. This is the type of event contemplated by these regulations and the safety of the participants depends upon control of vessel traffic, therefore the regulations in 33 CFR 100.507 are implemented. During the swim itself, all vessel traffic

will have to be stopped. However, vessel traffic will be permitted to transit the regulated area as the swim progresses. As a result, commercial traffic should not be severely disrupted.

Dated: April 9, 1994.

W. T. Leland,

Rear Admiral, U.S. Coast Guard Commander, Fifth Coast Guard District.

[FR Doc. 94-11710 Filed 5-12-94; 8:45 am]

BILLING CODE 4910-14-M

33 CFR Part 100

[CGD 05-94-013]

Special Local Regulations for Marine Events; The Start of the Cock Island Race; Norfolk Harbor, Elizabeth River, Norfolk and Portsmouth, VA

AGENCY: Coast Guard, DOT.

ACTION: Notice of Implementation.

SUMMARY: This notice implements special local regulations for the start of the Cock Island Race from the Portsmouth Seawall area of the Southern Branch of the Elizabeth River, Norfolk Harbor, Norfolk and Portsmouth, VA on July 16, 1994. The sailboats will race to Hampton Roads and return. These special local regulations are needed to control vessel traffic within the area due to the confined nature of the waterway and the expected vessel congestion during the starting of the races. The effect will be to restrict general navigation in the regulated area for the safety of participants in the races.

EFFECTIVE DATES: This regulation is effective from 8:30 a.m. to 5 p.m., on July 16, 1994.

FOR FURTHER INFORMATION CONTACT: Stephen L. Phillips, Chief, Boating Affairs Branch, Fifth Coast Guard District 431, Crawford Street, Portsmouth, Virginia 23705 (804) 398-6204, or Commander, Coast Guard Group, Hampton Roads (804) 483-8568.

Drafting Information:

The drafters of this notice are QM2 Gregory C. Garrison, project officer, Boating Affairs Branch, Boating Safety Division, Fifth Coast Guard District, and LT Monica L. Lombardi, project attorney, Fifth Coast Guard District Legal Staff.

Discussion of Regulation:

Ports Events, Inc., of Portsmouth, Virginia, submitted an application to hold the Cock Island Race. The race will consist of over 200 sailboats ranging from 22 to 60 feet. The sailboats will be divided into several classes. Each class

will start at ten minute intervals from the Portsmouth Seawall area of the Southern Branch of the Elizabeth River, Norfolk Harbor, Norfolk and Portsmouth, Virginia on July 16, 1994, race to Hampton Roads and return. Because this is the type of event contemplated by these regulations, and because the safety of the participants would be enhanced by the implementation of the special local regulations for this regulated area, the regulations in 33 CFR 100.501 are being implemented for the start of the races.

Dated: May 2, 1994.

W. T. Leland,

Rear Admiral, U.S. Coast Guard Commander, Fifth Coast Guard District.

[FR Doc. 94-11712 Filed 5-12-94; 8:45 am]

BILLING CODE 4910-14-M

33 CFR Part 100

[CGD 05-94-014]

Special Local Regulations for Marine Events; Great American Music Festival Fireworks, Elizabeth River, Town Point, Norfolk and Portsmouth, VA

AGENCY: Coast Guard, DOT.

ACTION: Notice of Implementation.

SUMMARY: This notice implements special local regulations for the Great American Music Festival Fireworks Display to be held in the Waterside area of the Elizabeth River between Norfolk and Portsmouth, VA. These special local regulations are needed to control vessel traffic within the immediate vicinity of Waterside due to the confined nature of the waterway and the expected vessel congestion during the event. The effect will be to restrict general navigation in the regulated area for the safety of participants and spectators.

EFFECTIVE DATES: This regulation is effective from 8:30 p.m. to 11 p.m., July 3, 1994.

If inclement weather causes the postponement of the July 3, 1994 fireworks display, the regulations will be in effect from 8:30 p.m. to 11 p.m., July 4, 1994.

FOR FURTHER INFORMATION CONTACT: Stephen L. Phillips, Chief, Boating Affairs Branch, Fifth Coast Guard District, 431 Crawford Street, Portsmouth, Virginia 23705 (804) 398-6204, or Commander, Coast Guard Group Hampton Roads (804) 483-8559.

Drafting Information:

The drafters of this notice are QM2 Gregory C. Garrison, project officer, Boating Affairs Branch, Boating Safety Division, Fifth Coast Guard District, and