

(f) *Allocation of income and loss by a corporation that is a member of the expanded affiliated group for only a portion of the year*—(1) *In general.* A corporation that becomes or ceases to be a member of an EAG during its taxable year must allocate its taxable income or loss, QPAI, and W–2 wages between the portion of the taxable year that it is a member of the EAG and the portion of the taxable year that it is not a member of the EAG. This allocation of items is made by using the pro rata allocation method described in this paragraph (f)(1). Under the pro rata allocation method, an equal portion of a corporation's taxable income or loss, QPAI, and W–2 wages for the taxable year is assigned to each day of the corporation's taxable year. Those items assigned to those days that the corporation was a member of the EAG are then aggregated.

\* \* \* \* \*

(g) \* \* \*

(3) *Example.* The following example illustrates the application of paragraphs (f) and (g) of this section:

*Example.* (i) *Facts.* Corporations X and Y, calendar year corporations, are members of the same EAG for the entire 2010 taxable year. Corporation Z, also a calendar year corporation, is a member of the EAG of which X and Y are members for the first half of 2010 and not a member of any EAG for the second half of 2010. During the 2010 taxable year, neither X, Y, nor Z join in the filing of a consolidated Federal income tax return. Assume that X, Y, and Z each have W–2 wages in excess of the section 199(b) wage limitation for all relevant periods. In 2010, X has taxable income of \$2,000 and QPAI of \$600, Y has a taxable loss of \$400 and QPAI of (\$200), and Z has taxable income of \$1,400 and QPAI of \$2,400.

(ii) *Analysis.* Pursuant to the pro rata allocation method, \$700 of Z's 2010 taxable income and \$1,200 of Z's 2010 QPAI are allocated to the first half of the 2010 taxable year (the period in which Z is a member of the EAG) and \$700 of Z's 2010 taxable income and \$1,200 of Z's 2010 QPAI are allocated to the second half of the 2010 taxable year (the period in which Z is not a member of any EAG). Accordingly, in 2010, the EAG has taxable income of \$2,300 (X's \$2,000 + Y's (\$400) + Z's \$700) and QPAI of \$1,600 (X's \$600 + Y's (\$200) + Z's \$1,200). The EAG's section 199 deduction for 2010 is therefore \$144 (9% of the lesser of the EAG's \$2,300 of taxable income or \$1,600 of QPAI). Pursuant to § 1.199–7(c)(1), this \$144 deduction is allocated to X, Y, and Z in proportion to their respective QPAI. Accordingly, X is allocated \$48 of the EAG's section 199 deduction, Y is allocated \$0 of the EAG's section 199 deduction, and Z is allocated \$96 of the deduction. For the second half of 2010, Z has taxable income of \$700 and QPAI of \$1,200. Therefore, for the second half of 2010, Z has a section 199 deduction of \$63 (9% of the lesser of its \$700

taxable income or \$1,200 QPAI for the second half of 2010). Accordingly, X's 2010 section 199 deduction is \$48, Y's 2010 section 199 deduction is \$0, and Z's 2010 section 199 deduction is \$159, the sum of the \$96 section 199 deduction of the EAG allocated to Z for the first half of 2010 and Z's \$63 section 199 deduction for the second half of 2010.

**Par. 4.** Section 1.199–8 is amended by:

1. Adding two sentences at the end of paragraph (a).

2. Adding new paragraphs (i)(8) and (i)(9).

The revisions and additions read as follows:

**§ 1.199–8 Other rules.**

(a) \* \* \* For purposes of §§ 1.199–1 through 1.199–9, use of terms such as *payment, paid, incurred, or paid or incurred* is not intended to provide any specific rule based upon the use of one term versus another. In general, the use of the term *payment, paid, incurred, or paid or incurred* is intended to convey the appropriate standard under the taxpayer's method of accounting.

\* \* \* \* \*

(i) \* \* \*

(8) *Qualified film produced by the taxpayer.* Section 1.199–3(k) is proposed to be applicable to taxable years beginning on or after the date the final regulations are published in the **Federal Register**. Until the date the final regulations are published in the **Federal Register**, taxpayers may rely on § 1.199–3(k) of these proposed regulations for taxable years beginning after December 31, 2004. However, for taxable years beginning before June 1, 2006, a taxpayer may rely on § 1.199–3(k) of the proposed regulations only if the taxpayer does not apply Notice 2005–14 (2005–1 CB 498) (see § 601.601(d)(2)(ii)(b) of this chapter) or REG–105847–05 (2005–2 CB 987) (see § 601.601(d)(2)(ii)(b) of this chapter) to the taxable year.

(9) *Expanded affiliated groups.* Section 1.199–7(e), *Example 10*, and § 1.199–7(f)(1) are proposed to be applicable to taxable years beginning on or after the date the final regulations are published in the **Federal Register**. Until the date the final regulations are published in the **Federal Register**, taxpayers may rely on § 1.199–7(e), *Example 10*, of these proposed regulations for taxable years beginning after December 31, 2004.

**Kevin M. Brown,**

*Deputy Commissioner for Services and Enforcement.*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[REG–157711–02]

RIN 1545–BB61

**Unified Rule for Loss on Subsidiary Stock; Correction**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Correction to notice of proposed rulemaking.

**SUMMARY:** This document contains corrections to a notice of proposed rulemaking that were published in the **Federal Register** on Tuesday, January 23, 2007 (72 FR 2964). These regulations apply to corporations filing consolidated returns. The regulations implement aspects of the repeal of the *General Utilities* doctrine by redetermining members' bases in subsidiary stock and requiring certain reductions in subsidiary stock basis on a transfer of the stock. The regulations promote the clear reflection of income by redetermining members' bases in subsidiary's stock and reducing the subsidiary's attributes to prevent the duplication of loss, and they also, provide guidance limiting the application of section 362(e)(2) with respect to transactions between members of a consolidated group.

**FOR FURTHER INFORMATION CONTACT:** Theresa Abell (202) 622–7700 or Phoebe Bennett (202) 622–7770 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

The notice of proposed rulemaking (REG–157711–02) that is the subject of these corrections are under sections 358, 362(e)(2) and 1502 of the Internal Revenue Code.

**Need for Correction**

As published, the notice of proposed rulemaking (REG–157711–02) contains errors that may prove to be misleading and are in need of clarification.

**Correction of Publication**

Accordingly, the publication of the notice of proposed rulemaking (REG–157711–02), that is the subject of FR Doc. 07–187, is corrected as follows:

1. On page 2964, column 2, in the preamble, under the paragraph heading “Paperwork Reduction Act”, eighth paragraph of the column, line 3, the language “13(e)(4)(v) and 1.1502–36(d)(7). The” is corrected to read “13(e)(4)(v) and 1.1502–36(d)(6). The”.

2. On page 2964, column 3, in the preamble, under the paragraph heading "Background", second paragraph of the column, line 10, the language "*v. United States*, 255 F.3d 1357 (2001)," is corrected to read "*v. United States*, 255 F.3d 1357 (Fed. Cir. 2001)."

3. On page 2965, column 1, in the preamble, under the paragraph heading "2. The Administrative Response to GU Repeal: § 1.1502-20.", first paragraph, line 2 from bottom of the paragraph, the language "determine adjustments to member's" is corrected to read "determine adjustments to members".

4. On page 2972, column 1, in the preamble, under the paragraph heading "2. Hybrid Tracing-Presumptive Model: Asset Tracing.", first paragraph, line 3, the language "presumption approach that would" is corrected to read "presumptive approach that would".

5. On page 2972, column 2, in the preamble, the paragraph heading "3. Presumption-Based Models" is corrected to read "3. Presumptive-Based Models."

6. On page 2975, column 1, in the preamble, under the paragraph heading "d. *Netting of items from different tax periods.*", first paragraph, line 6, the language, "investments were not. The IRS and" is corrected to read "investment adjustments were not. The IRS and".

7. On page 2975, column 1, in the preamble, under the paragraph heading "d. *Netting of items from different tax periods.*", second paragraph, line 8, the language, "account by the group. Thus, IRS and" is corrected to read "account by the group. Thus, the IRS and".

8. On page 2975, column 2, in the preamble under the paragraph heading "e. *Summary and conclusions.*", second paragraph, line 12 from the bottom of the paragraph, the language "administrative and other concerns" is corrected to read "administrative burden and other concerns".

9. On page 2977, column 1, in the preamble, under the paragraph heading "E. *Noneconomic and Duplicated Loss From Investment Adjustment System.*", first paragraph, line 2, the language "preamble, IRS and Treasury Department" is corrected to read "preamble, the IRS and Treasury Department".

10. On page 2978, column 3, under paragraph heading "1. Overview.", third paragraph of the column, line 4 from the bottom of the paragraph, the language "implement a loss limitation approach" is corrected to read "implements a loss limitation approach".

11. On page 2980, column 1, under paragraph heading "4. The Attribute Reduction Rule.", second paragraph,

lines 16 and 17, the language "the value of all of the S shares. Net the inside attributes generally has the same" is corrected to read "the value of all the S shares. The term net inside attributes generally has the same".

12. On page 2980, column 1, under paragraph heading "4. The Attribute Reduction Rule.", third paragraph, last line of the column, the language "stock loss for a later recognition (for" is corrected to read "stock loss for later recognition (for".

13. On page 2980, column 2, under paragraph heading "4. The Attribute Reduction Rule.", second paragraph of the column, lines 1 and 2 from bottom of the paragraph, the language "attributes are reduced reflects this principle." is corrected to read "attributes are reduced reflects these principles."

14. On page 2980, column 3, under subparagraph heading "a. *Special rules applicable when S holds stock of lower-tier subsidiary.*", second paragraph, line 16, the language "inside attributes. For example, if P owns" is corrected to read "inside attributes. For example, assume P owns".

15. On page 2981, column 3, under subparagraph heading "b. *Election to reduce stock basis and/or reattribute loss.*", first paragraph of the column, line 22 from bottom of the paragraph, the language "transaction. Proposed regulations under" is corrected to read "transaction."

16. On page 2981, column 3, under subparagraph heading "b. *Election to reduce stock basis and/or reattribute loss.*", second paragraph, line 21 from bottom of the paragraph, the language "§ 1.1502-32 treat the reattributed" is corrected and added with new paragraph to read "Proposed regulations under § 1.1502-32 treat the reattributed".

17. On page 2982, column 1, under subparagraph heading "6. Special Rules for Section 362(e)(2) Transaction.", second paragraph, lines 1 and 2 from bottom of the column, the language "under section 362(e)(2)(C) been made Similarly, to adjust for distortions" is corrected to read "under section 362(e)(2)(C) been made. Similarly, to adjust for distortions".

18. On page 2982, column 2, under subparagraph heading "6. Special Rules for Section 362(e)(2) Transaction.", second paragraph of the column, line 9 from the bottom of the paragraph, the language, "stock basis and net inside attributes that" is corrected to read "stock basis, net inside attributes, and value that".

19. On page 2983, column 2, under subparagraph heading "2. Suspension of

Section 362(e)(2) for Intercompany Transactions.", last paragraph of the column, line 2 from bottom of the column, the language "investment adjustment system has not" is corrected to read "investment adjustment system has not eliminated".

20. On page 2984, column 2, under subparagraph heading "4. Application of Section 362(e)(2) to Intercompany Transactions.", first paragraph of the column, line 7 from the bottom of the paragraph, the language "attributes is applied to proportionately" is corrected to read "attributes is applied proportionately".

21. On page 2984, column 3, under subparagraph heading "5. Special Allocations Under § 1.1502-32.", line 7 of the paragraph, the language "entirely to member's shares. In other" is corrected to read "entirely to members" shares. In other".

22. On page 2986, column 2, under subparagraph heading, "8. Retention of, and Nonsubstantive Revisions to, § 1.1502-80(c).", third paragraph of the column, line 8 of the paragraph, the language "under the LDR and, since LDR no longer" is corrected to read "under the LDR and, since the LDR no longer".

23. On page 2986, column 3, under subparagraph heading, "8. Retention of, and Nonsubstantive Revisions to, § 1.1502-80(c).", first paragraph of the column, line 2 of the column, the language "deduction. See, *In re Prudential Lines.*" is corrected to read "deduction. See *In re Prudential Lines.*".

#### § 1.1502-13 [Corrected]

24. On page 2988, column 1, § 1.1502-13(e)(4)(ii)(C)(2), line 12 from bottom of the column, the language "otherwise is eliminated (other than" is corrected to read "otherwise eliminated (other than)".

25. On page 2989, column 3, § 1.1502-13(e)(4)(vi), *Example 3*(iv), line 18 of the paragraph, the language "in § 1.1502-32(b)(3)(iii)(B), and will effect P's" is corrected to read "in § 1.1502-32(b)(3)(iii)(B), and will affect P's".

#### § 1.1502-32 [Corrected]

26. On page 2991, column 3, § 1.1502-32(b)(3)(iii)(C), line 3 from bottom of the paragraph, the language "Federal Register, see 1.1502-" is corrected to read "Federal Register, see § 1.1502-".

27. On page 2991, column 3, § 1.1502-32(b)(3)(iii)(D), line 3 from bottom of the paragraph, the language "see 1.1502-32(b)(3)(iii)(D) as

contained” is corrected to read “see § 1.1502–32(b)(3)(iii)(D) as contained”.

28. On page 2991, column 3, § 1.1502–32(c)(1)(i), line 2 from bottom of the column, the language “allocated to the shares of S’s stock to” is corrected to read “allocated to the shares of S stock to”.

29. On page 2993, column 1, § 1.1502–32(c)(1)(ii)(A)(2) *Example.(iv)(D)*, line 7 from bottom of the column, the language “nondeductible basis recovery item if it is” is corrected to read “nondeductible basis recovery item if it were”.

30. On page 2994, column 1, § 1.1502–32(c)(2)(i), line 11, the language “that member’s excess loss accounts and” is corrected to read “that member’s excess loss account and”.

31. On page 2994, column 2, § 1.1502–32(c)(4)(i), line 3 of the paragraph, the language “share of S’s preferred and common stock” is corrected to read “share of S preferred and common stock”.

32. On page 2994, column 2, § 1.1502–32(c)(4)(i), line 8 of the paragraph, the language “made by reallocating S’s adjustments” is corrected to read “made by reallocating S stock adjustments”.

33. On page 2994, column 2, § 1.1502–32(c)(4)(i), last line of the paragraph, the language “of S’s shares. \* \* \*” is corrected to read “of the S shares. \* \* \*”.

#### § 1.1502–35 [Corrected]

34. On page 2994, column 3, § 1.1502–35(a), line 5 from bottom of the paragraph, the language “of April 1, 2006. For transfers and” is corrected to read “of April 1, 2007. For transfers and”.

35. On page 2995, column 1, § 1.1502–35(b)(3)(iii), line 4, the language “year of the group) is a noncapital,” is corrected to read “year of the selling group) is a noncapital.”.

#### § 1.1502–36 [Corrected]

36. On page 2995, column 2, the language of the section heading “§ 1.1502–36 Loss on subsidiary stock.” is corrected to read “§ 1.1502–36 Unified rule for loss on subsidiary stock.”.

37. On page 2996, column 2, § 1.1502–36(b)(1)(i), line 4 of the paragraph, the language “(b) reduce the extent to which there is” is corrected to read “(b) reduce (but do not increase) the extent to which there is”.

38. On page 2997, column 1, § 1.1502–36(b)(2)(iii)(A), line 2 of the paragraph, the language “Reallocations are made in a manner that” is corrected to read “All reallocations (both to and

from members’ shares of S stock) are made in a manner that”.

39. On page 2997, column 2, § 1.1502–36(b)(2)(iii)(B)(2)(ii) *Example.(iii)*, line 6 from the bottom of the column, the language “would have tiered up to the M share P sold,” is corrected to read “would have tiered up to the M share that P sold.”.

40. On page 2998, column 2, § 1.1502–36(b)(3) *Example 2.(i)*, line 10 of the paragraph, the language “Asset 1 for \$100. On December 31, year 2, S” is corrected to read “Asset 1 for \$100. On December 31, year 2, P”.

41. On page 2999, column 2, § 1.1502–36(b)(3) *Example 3.(i)*, line 5 of the paragraph, the language “preferred shares to reflect their entitlement to” is corrected to read “preferred shares to reflect its entitlement to”.

42. On page 2999, column 3, § 1.1502–36(b)(3) *Example 3.(ii)(C)*, line 8 of the paragraph, the language “Accordingly \$25 of that amount is reallocated” is corrected to read “Accordingly, \$25 of that amount is reallocated”.

43. On page 3000, column 2, § 1.1502–36(c)(6)(i), line 5 from the bottom of the paragraph, the language “S1’s investment adjustments increased” is corrected to read “S1’s investment adjustments increase”.

44. On page 3000, column 3, § 1.1502–36(c)(6)(v) *Example.(ii)*, line 3 from the bottom of the paragraph, the language “the loss share stock of S1, the lowest-tier” is corrected to read “the loss share of S1 stock, the lowest-tier”.

45. On page 3000, column 3, § 1.1502–36(c)(6)(v) *Example.(iii)*, line 3 from the bottom of the paragraph, the language “recognized on the transfer of S3 tiers up to” is corrected to read “recognized on the transfer of S3 stock tiers up to”.

46. On page 3001, column 3, § 1.1502–36(c)(8) *Example 1.(i)(C)*, line 13 of the paragraph, the language “recognized on the sale of Asset 1. Thus the” is corrected to read “recognized on the sale of Asset 1. Thus, the”.

47. On page 3001, column 3, § 1.1502–36(c)(8) *Example 1.(ii)*, line 5 from the bottom of the paragraph, the language “Asset 1 to \$0) Because the net positive” is corrected to read “Asset 1 to \$0). Because the net positive”.

48. On page 3002, column 3, § 1.1502–36(c)(8) *Example 1.(iv)(B)*, line 4 of the paragraph, the language “there redetermination would change no” is corrected to read “redetermination would change no”.

49. On page 3003, column 2, § 1.1502–36(c)(8) *Example 4.(ii)*, lines 4 through 10 of the column, the language “Because the net positive adjustment

includes items of income (and not just gain), the analysis of the application of this paragraph (c) is the same here as in paragraph (i)(C) of this *Example 4*. Furthermore, the analysis of the application of this paragraph (C) would also be the same if the \$60 loss carryover were subject to a section 382 limitation from a prior ownership change, and if, instead, it would subject to the limitation in § 1.1502–” is corrected to read “The analysis of the application of this paragraph (c) is the same here as in paragraph (i)(C) of this *Example 4*. Furthermore, the analysis of the application of this paragraph (c) would also be the same if the \$60 loss carryover were subject to a section 382 limitation from a prior ownership change, if, instead, it were subject to the limitation in § 1.1502–”.

50. On page 3003, column 2, § 1.1502–36(c)(8) *Example 5.(i)*, lines 7 through 10 of the paragraph, the language “December 31, year 1, P sells one of its shares, Share 1, for \$20. After applying and giving effect to all generally applicable rules of law (other than this section), P’s basis in its Share” is corrected to read “December 31, year 1, P sells one of its S shares, Share 1, for \$20. After applying and giving effect to all generally applicable rules of law (other than this section), P’s basis in Share”.

51. On page 3003, column 2, § 1.1502–36(c)(8) *Example 5.(iii)*, line 6 from the bottom of the paragraph, the language “(\$100 from the sale of the asset), and Share” is corrected to read “(\$100 from the sale of Asset), and Share”.

52. On page 3004, column 3, § 1.1502–36(c)(8) *Example 7.(i)*, line 8 from the bottom of the paragraph, the language “basis in S1 under § 1.1502–32 by \$40 (to)” is corrected to read “basis in the S1 share under § 1.1502–32 by \$40 (to)”.

53. On page 3006, column 2, § 1.1502–36(d)(5)(ii)(B)(3), line 3 from the bottom of the paragraph, the language “extent necessary to reduce the bases of” is corrected to read “extent necessary to reduce the basis of”.

54. On page 3006, column 2, § 1.1502–36(d)(5)(ii)(B)(4), line 2 from the bottom of the paragraph, the language “the basis of such shares without” is corrected to read “the bases of such shares without”.

55. On page 3007, column 1, § 1.1502–36(d)(6)(ii)(B), line 5 from the bottom of the paragraph, the language “immediately tier up (under the)” is corrected to read “immediately tiers up (under the)”.

56. On page 3007, column 3, § 1.1502-36(d)(6)(iv), line 4 of the paragraph, the language “all members’ basis in loss shares of S” is corrected to read “all members’ bases in loss shares of S”.

57. On page 3007, column 3, § 1.1502-36(d)(7) *Example 1.(i)(B)*, line 3 of the paragraph, the language “under paragraph (b) of this section either” is corrected to read “under paragraph (b) of this section because”.

58. On page 3008, column 1, § 1.1502-36(d)(7) *Example 1.(i)(B)*, line 2 of the column, the language “disparity in the basis of the shares). See” is corrected to read “disparity in the bases of the shares). See”.

59. On page 3009, column 2, § 1.1502-36(d)(7) *Example 4.(i)(A)*, line 4 of the column, the language “the \$500 income earned). The sale is” is corrected to read “the \$500 of income earned). The sale is”.

60. On page 3010, column 2, § 1.1502-36(d)(7) *Example 5.(i)(C)(3)*, line 10 from the bottom of the paragraph, the language “the transaction (\$50) over the sum of” is corrected to read “the transaction (\$50) over the sum of the”.

61. On page 3010, column 3, § 1.1502-36(d)(7) *Example 5.(ii)(C)(4)*, lines 15 to 21 of the paragraph, the language “reductions to share A and to share B under this paragraph (d) are reversed to restore the basis of each share to \$12.50. Thus, \$25 of the \$27.50 attribute reduction applied to reduce the basis of share A and \$25 of the \$47.50 attribute reduction applied to reduce the basis of share B are reversed, restoring the” is corrected to read “reductions to Share A and to Share B under this paragraph (d) are reversed to restore the basis of each share to \$12.50. Thus, \$25 of the \$27.50 attribute reduction applied to reduce the basis of Share A and \$25 of the \$47.50 attribute reduction applied to reduce the basis of Share B are reversed, restoring the”.

62. On page 3011, column 2, § 1.1502-36(d)(7) *Example 6.(ii)(B)*, line 2 from the bottom of the column, the language “basis in subsidiary stock under the principles” is corrected to read “bases in subsidiary stock under the principles”.

63. On page 3011, column 3, § 1.1502-36(d)(7) *Example 6.(ii)(B)*, line 2 from the top of the column, the language “the transaction the sale is not subject to” is corrected to read “the transaction, the sale is not subject to”.

64. On page 3011, column 3, § 1.1502-36(d)(7) *Example 6.(ii)(C)*, line 3 of the paragraph, the language “this section). The next highest tier transfer

is” is corrected to read “this section). The next higher tier transfer is”.

65. On page 3011, column 3, § 1.1502-36(d)(7) *Example 6.(ii)(C)*, line 8 from the bottom of the paragraph, the language “of the transferred Share E minus the \$20” is corrected to read “of the transferred share E minus the \$20”.

66. On page 3011, column 3, § 1.1502-36(d)(7) *Example 6.(ii)(D)(1)*, line 6 from the bottom of the paragraph, the language “basis in its asset) minus S’s liability (\$20).” is corrected to read “basis in its asset)) minus S’s liability (\$20).”.

67. On page 3011, column 3, § 1.1502-36(d)(7) *Example 6.(ii)(D)(2)*, lines 5 to 6 from the bottom of the paragraph, the language “applied to reduce the basis of share E because share E was transferred in a transaction in” is corrected to read “applied to reduce the basis of share E, because share E was transferred in a transfer in”.

68. On page 3011, column 3, § 1.1502-36(d)(7) *Example 6.(ii)(D)(3)*, line 3 from the bottom of the column, the language “apportioned to or applied to reduced the” is corrected to read “apportioned to or applied to reduce the”.

69. On page 3012, column 3, § 1.1502-36(d)(7) *Example 7.(iii)(C)(3)*, line 16 of the paragraph, the language “reducing the basis of both assets to \$0.” is corrected to read “reducing the basis of each asset to \$0.”.

70. On page 3012, column 3, § 1.1502-36(d)(7) *Example 7.(iii)(C)(3)*, line 2 from the bottom of the paragraph, the language “attribute reduction amount is disregarded has” is corrected to read “attribute reduction amount is disregarded and has”.

71. On page 3013, column 1, § 1.1502-36(d)(7) *Example 8.(i)(E)*, line 5 of the paragraph, the language “basis in the S shares by the full attribute” is corrected to read “bases in the S shares by the full attribute”.

72. On page 3013, column 2, § 1.1502-36(d)(7) *Example 8.(i)(E)*, line 7 of the paragraph, the language “transfer. The reduction of M’s basis in the S” is corrected to read “transfer. The reduction of M’s bases in the S”.

73. On page 3014, column 1, § 1.1502-36(d)(7) *Example 8.(ii)(E)*, lines 2 through 5 of the paragraph, the language “are the same as paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reduce M’s basis in the S shares by the full attribute” is corrected to read “are the same as in paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reduce M’s bases in the S shares by the full attribute”.

74. On page 3014, column 1, § 1.1502-36(d)(7) *Example 8.(ii)(F)*, is removed.

75. On page 3014, column 1, § 1.1502-36(d)(7) *Example 8.(ii)(G)*, is the newly designated paragraph (F).

76. On page 3014, column 2, § 1.1502-36(d)(7) *Example 9.(i)*, line 5 from the bottom of the column, the language “to P1 (the common parent of a consolidated)” is corrected to read “to P1 (the common parent of a different consolidated”.

77. On page 3014, column 3, § 1.1502-36(d)(7) *Example 9.(ii)*, line 7 from the bottom of the column, the language “computed and is applied to adjust the basis” is corrected to read “computed and is applied to adjust the bases”.

78. On page 3015, column 1, § 1.1502-36(d)(7) *Example 9.(iii)*, line 1 of the paragraph, the language “(iii) *Transfers in next highest tier (loss)*” is corrected to read “(iii) *Transfers in next higher tier (loss)*”.

79. On page 3015, column 3, § 1.1502-36(d)(7) *Example 9.(iv)(B)(2)*, line 30 from the bottom of the paragraph, the language “allocated amount is apportioned among other” is corrected to read “allocated amount is apportioned among the other”.

80. On page 3017, column 1, § 1.1502-36(e)(1), last line of the paragraph, the language “the section.” is corrected to read “this section.”.

81. On page 3017, column 2, § 1.1502-36(e)(2)(iii), line 6 of the paragraph, the language “allocable portion of S’s attributes has” is corrected to read “allocable portion of S’s net inside attributes has”.

82. On page 3017, column 2, § 1.1502-36(e)(2)(iv) *Example.(i)(A)*, line 11 of the paragraph, the language “basis of A1 would have been reduced by \$80” is corrected to read “basis in Asset 1 would have been reduced by \$80”.

83. On page 3017, column 2, § 1.1502-36(e)(2)(iv) *Example.(i)(B)*, last line of the paragraph, the language “to this paragraph (c).” is corrected to read “to paragraph (c) of this section.”.

84. On page 3018, column 1, § 1.1502-36(f)(2), line 6 of the column, the language “dealers in securities) and 481” is corrected to read “dealers in securities) and section 481”.

85. On page 3018, column 1, § 1.1502-36(f)(4), lines 6 through 15 of the paragraph, the language “basis of shares of S2 stock under § 1.1502-32 affect the investment adjustments made to the basis of the stock of S1. A subsidiary (S1) (and its shares of stock) is *lower tier* with respect to another subsidiary (S) (and its shares of stock)

if investment adjustments made to the basis of shares of S1 stock affect the investment adjustments made to the basis of shares of S stock. The” is corrected to read “bases of shares of S2 stock under § 1.1502–32 affect the investment adjustments made to the bases of shares of S1 stock. A subsidiary (S1) (and its shares of stock) is lower tier with respect to another subsidiary (S) (and its shares of stock) if investment adjustments made to the bases of shares of S1 stock affect the investment adjustments made to the bases of shares of S stock. The”.

86. On page 3019, column 1, § 1.1502–36(g)(2) *Example 3.(ii)*, line 4 of the paragraph, the language “there is no disparity in the basis of the” is corrected to read “there is no disparity in the bases of the”.

87. On page 3019, column 1, § 1.1502–36(g)(2) *Example 4.(i)*, lines 5 through 6 from the bottom of the paragraph, the language “equal basis that exceeds value. S owns Asset 1 with a basis that exceeds value and cash.” is corrected to read “equal basis that exceeds value. S owns Cash and Asset 1 with a basis that exceeds value.”.

88. On page 3019, column 1, § 1.1502–36(g)(2) *Example 4.(ii)*, line 4 of the paragraph, the language “there is no disparity in the basis of the” is corrected to read “there is no disparity in the bases of the”.

**LaNita Van Dyke,**

*Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 20**

[REG–119097–05]

RIN 1545–BE52

**Grantor Retained Interest Trusts—  
Application of Sections 2036 and 2039**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations providing guidance on the portion of a trust properly includible in a grantor’s gross estate under Internal Revenue Code (Code) sections 2036 and 2039 if the grantor has retained the use of property in a trust or the right to an annuity,

unitrust, or other income payment from such trust for life, for any period not ascertainable without reference to the grantor’s death, or for a period that does not in fact end before the grantor’s death. This document also provides notice of a public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by September 5, 2007. Outlines of topics to be discussed at the public hearing scheduled for September 26, 2007, must be received by September 5, 2007.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG–119097–05), Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to the Courier’s Desk, Internal Revenue Service, Attn: CC:PA:LPD:PR (REG–119097–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044. Alternatively, submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–119097–05), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG–119097–05). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Theresa M. Melchiorre, (202) 622–7830; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622–7180 (not toll-free numbers) or e-mail at [Richard.A.Hurst@irsounsel.treas.gov](mailto:Richard.A.Hurst@irsounsel.treas.gov).

**SUPPLEMENTARY INFORMATION:**

**Background**

The proposed regulations provide guidance on what portion of a trust is includible in the deceased grantor’s gross estate under section 2036 if the grantor retained the right to use property in the trust or the right to receive from that trust an annuity, unitrust, or other income payment for the grantor’s life, for any period not ascertainable without reference to the grantor’s death, or for any period that does not in fact end before the grantor’s death. In addition, the proposed regulations provide guidance on the possible application of section 2039 to trusts in which the decedent has retained the use of property held in the trust or has retained an annuity,

unitrust, or other income interest that is includible in the decedent’s gross estate under section 2036. These trusts include without limitation certain charitable trusts (collectively CRTs) such as charitable remainder annuity trusts (CRATs) within the meaning of section 664(d)(1), charitable remainder unitrusts (CRUTs) within the meaning of section 664(d)(2) or (d)(3), and charitable remainder trusts that do not qualify under section 664, as well as other trusts established by a grantor (collectively GRTs) such as grantor retained annuity trusts (GRATs), grantor retained unitrusts (GRUTs), and various forms of grantor retained income trusts (GRITs), such as qualified personal residence trusts (QPRTs) and personal residence trusts (PRTs). A CRT is within the scope of these proposed regulations whether or not the CRT meets the qualifications of sections 664(d)(1), (2), or (3) and a GRT is within the scope of these proposed regulations whether or not the grantor’s retained interest is a “qualified interest” as defined in section 2702(b). This guidance does not apply to trusts or other contractual arrangements arising by reason of a decedent’s employment and generally does not apply to annuities purchased by the decedent, as these types of interests fall within the ambit of section 2039.

Under section 2036(a), a decedent’s gross estate includes the value of any interest in property transferred by the decedent in which the decedent retained for the decedent’s life, for any period not ascertainable without reference to the decedent’s death, or for any period that does not in fact end before the decedent’s death, either the possession or enjoyment of the property or a right to the income from the property, or the right (either alone or with another) to designate the persons who may possess or enjoy the property or its income. Section 20.2036–1(a) provides generally that, if the decedent retained or reserved an interest with respect to all of the property transferred by the decedent, the amount to be included in the gross estate under section 2036 is the value of the entire property on the date of death. If the decedent retained a right with respect to only part of the property transferred, the amount to be included in the decedent’s gross estate under section 2036 is the corresponding proportionate amount of the corpus. Rev. Rul. 76–273, 1976–2 CB 268, and Rev. Rul. 82–105, 1982–1 CB 133 (See § 601.601(d)(2)), generally provide that the portion of the corpus of a CRUT and CRAT includible in the decedent’s gross estate under section