

and irregular, in the employment of defense articles. Technical assistance agreements must be submitted in such cases. In exceptional cases, the Directorate of Defense Trade Controls, upon written request, will consider approving the provision of defense services described in § 120.9(a) of this subchapter by granting a license under part 125 of this subchapter.

\* \* \* \* \*

6. In § 124.2, paragraph (a) is removed and reserved and paragraph (c) introductory text is revised to read as follows:

**§ 124.2 Exemptions for training and military service.**

(a) [Reserved]

\* \* \* \* \*

(c) For NATO countries, Australia, Japan and Sweden, in addition to the basic maintenance information exemption in § 125.4(b)(5) of this subchapter, no technical assistance agreement is required for maintenance training or the performance of maintenance, including the export of supporting technical data, when the following criteria can be met:

\* \* \* \* \*

Dated: April 5, 2011.

**Ellen O. Tauscher,**

*Under Secretary, Arms Control and International Security, Department of State.*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[REG-154159-09]

RIN 1545-BJ14

**Guidance Under Section 108(a) Concerning the Exclusion of Section 61(a)(12) Discharge of Indebtedness Income of a Grantor Trust or a Disregarded Entity**

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

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations relating to the exclusion from gross income under section 108(a) of discharge of indebtedness income of a grantor trust or an entity that is disregarded as an entity separate from its owner. The proposed regulations provide rules regarding the term “taxpayer” for purposes of applying section 108 to

discharge of indebtedness income of a grantor trust or a disregarded entity. The proposed regulations affect grantor trusts, disregarded entities, and their owners.

**DATES:** Written or electronic comments and requests for a public hearing must be received by July 12, 2011.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-154159-09), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-154159-09), 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-154159-09).

**FOR FURTHER INFORMATION CONTACT:** Bryan A. Rimmke or Benjamin H. Weaver, (202) 622-3050 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

Section 61(a)(12) of the Internal Revenue Code (the Code) provides that income from the discharge of indebtedness is includable in gross income. However, such income may be excludable from gross income under section 108 in certain circumstances. Section 108(a)(1)(A) and (B) excludes from gross income any amount that would be includable in gross income by reason of the discharge of indebtedness of the taxpayer if the discharge occurs in a Title 11 case or to the extent the taxpayer is insolvent when the discharge occurs. Section 108(d)(1) through (3) provides the meaning of the terms “indebtedness of the taxpayer,” “Title 11 case,” and “insolvent,” for purposes of applying section 108, and each definition uses the term “taxpayer.” Section 7701(a)(14) defines a *taxpayer* as any person subject to any internal revenue tax.

Several types of disregarded entities exist under the Code and regulations. For instance, § 301.7701-2(a) of the Procedure and Administration Regulations provides that the term *business entity* includes an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3; an example of a disregarded entity under this provision is a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes. Additionally, some disregarded entities are created by

statute; examples of statutory disregarded entities include a corporation that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

The activities of an entity that is a disregarded entity are treated in the same manner as a sole proprietorship, branch, or division of the owner (except for certain employment and excise tax rules). Accordingly, for Federal income tax purposes, all assets, liabilities, and items of income, deduction, and credit of a disregarded entity are treated as assets, liabilities, and such items (as the case may be) of the owner of the disregarded entity.

A *grantor trust* is any portion of a trust that is treated (under subpart E of part I of subchapter J of chapter 1) as being owned by the grantor or another person. In the case of any grantor trust, items of income, deductions, and credits attributable to the trust are includable in computing the taxable income and credits of the owner.

**Explanation of Provisions**

The proposed regulations provide that, for purposes of applying section 108(a)(1)(A) and (B) to discharge of indebtedness income of a grantor trust or a disregarded entity, the term *taxpayer*, as used in section 108(a)(1) and (d)(1) through (3), refers to the owner(s) of the grantor trust or disregarded entity. The proposed regulations further provide that grantor trusts and disregarded entities themselves will not be considered owners for this purpose. Finally, the proposed regulations provide that, in the case of a partnership, the owner rules apply at the partner level to the partners of the partnership to whom the discharge of indebtedness income is allocable. Thus, for example, if a partnership holds an interest in a grantor trust or disregarded entity, the applicability of section 108(a)(1)(A) and (B) to discharge of indebtedness income of the grantor trust or disregarded entity is tested by looking to the partners to whom the income is allocable. If any partner is itself a grantor trust or disregarded entity, the applicability of section 108(a)(1)(A) and (B) is determined by looking through such grantor trust or disregarded entity to the ultimate owner(s) of such partner.

Some taxpayers have taken the position that the insolvency exception is available to the extent a grantor trust or disregarded entity is insolvent, even if its owner is not. The IRS and the Treasury Department do not believe this

is an appropriate application of the relevant statutory provisions. The proposed regulations clarify that, subject to the special rule for partnerships under section 108(d)(6), the insolvency exception is available only to the extent the owner is insolvent, as owner is determined as described in this preamble.

Some taxpayers have taken the position that the bankruptcy exception is available if a grantor trust or disregarded entity is under the jurisdiction of a bankruptcy court, even if its owner is not. These taxpayers may argue that because, for Federal income tax purposes, the disregarded entity is disregarded and the “taxpayer” is the owner of the disregarded entity’s assets and liabilities, the taxpayer is properly seen as being subject to the bankruptcy court’s jurisdiction. Under the proposed regulations, it is insufficient for the grantor trust or disregarded entity to be subject to the bankruptcy court’s jurisdiction. The proposed regulations clarify that, subject to the special rule for partnerships under section 108(d)(6), the bankruptcy exception is available only if the owner of the grantor trust or disregarded entity is subject to the bankruptcy court’s jurisdiction, as owner is determined as described in this preamble.

#### Proposed Effective/Applicability Date

These regulations are proposed to apply to discharge of indebtedness income occurring on or after the date final regulations are published in the **Federal Register**. No inference is intended that the provisions set forth in these proposed regulations are not current law.

#### Special Analyses

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

#### Comments and Requests for a Public Hearing

Before the proposed regulations are adopted as final regulations,

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

#### Drafting Information

The principal authors of these regulations are Bryan A. Rimmke and Benjamin H. Weaver, Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the IRS and Treasury Department participated in its development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendments to the Regulations

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

#### PART 1—INCOME TAXES

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

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

**Par. 2.** Section 1.108–9 is added to read as follows:

#### § 1.108–9 Application of insolvency and bankruptcy provisions of section 108 to disregarded entities and grantor trusts.

(a) *General rule.* For purposes of applying section 108(a)(1)(A) and (B) to discharge of indebtedness income of a grantor trust or disregarded entity, neither the grantor trust nor the disregarded entity shall be considered to be the “taxpayer,” as that term is used in section 108(a)(1) and (d)(1) through (3). Rather, for purposes of section 108(a)(1) and (d)(1) through (3) and subject to section 108(d)(6), the owner of the grantor trust or disregarded entity is the taxpayer. If indebtedness of a grantor trust or disregarded entity is discharged in a Title 11 case, section 108(a)(1)(A) will apply only to an owner of the grantor trust or disregarded entity that is under the jurisdiction of the court in a Title 11 case. If the grantor trust or disregarded entity is under the jurisdiction of the court in a Title 11

case, but the owner of the grantor trust or disregarded entity is not, section 108(a)(1)(A) will not apply to the discharge of indebtedness income. If indebtedness of a grantor trust or disregarded entity is otherwise discharged, section 108(a)(1)(B) will apply only to the extent the owner of the grantor trust or disregarded entity is insolvent. If the grantor trust or disregarded entity is insolvent, but the owner of the grantor trust or disregarded entity is not, section 108(a)(1)(B) will not apply to the discharge of indebtedness income.

(b) *Application to partnerships.* Under section 108(d)(6), in the case of a partnership, section 108(a)(1)(A) and (B) applies at the partner level. Accordingly, in the case of a partnership, paragraph (a) of this section applies to the partners of such partnership to whom the discharge of indebtedness income is allocable.

(c) *Definitions—(1) Disregarded entities.* For purposes of this section, a *disregarded entity* is an entity that is disregarded as an entity separate from its owner for Federal income tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes, a corporation that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

(2) *Grantor trust.* For purposes of this section, a *grantor trust* is any portion of a trust that is treated under subpart E of part I of subchapter J of chapter 1 as being owned by the grantor or another person.

(3) *Owner.* Notwithstanding any other provision of this section to the contrary, neither a grantor trust nor a disregarded entity shall be considered an owner for purposes of this section.

(d) *Effective/applicability date.* The rules of this section are proposed to apply to discharge of indebtedness income occurring on or after the date final regulations are published in the **Federal Register**.

**Steven T. Miller,**

*Deputy Commissioner for Services and Enforcement.*

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