even if it is excluded from certain label declarations. Finally, we reorganized the section detailing our consideration of allulose as a sugar.

The guidance announced in this notice finalizes the draft guidance with respect to: (1) Our views on the declaration of allulose on Nutrition Facts and Supplement Facts labels and on the caloric content of allulose; and (2) our intent to exercise enforcement discretion for the exclusion of allulose from the amount of Total Sugars and Added Sugars declared on the label and use of a general factor of 0.4 kcal/g for allulose when calculating declarations on Nutrition and Supplement Facts labels pending review of the issues in a rulemaking.

II. Paperwork Reduction Act of 1995

This guidance contains no collection of information. Therefore, clearance by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501–3521) is not required.

However, this guidance refers to previously approved FDA collections of information. These collections of information are subject to review by OMB under the PRA. The collections of information in 21 CFR part 101 have been approved under OMB control number 0910–0381.

II. Electronic Access

Persons with access to the internet may obtain the guidance at either *https://www.fda.gov/FoodGuidances* or *https://www.regulations.gov.* Use the FDA website listed in the previous sentence to find the most current version of the guidance.

Dated: October 9, 2020.

Lauren K. Roth,

Acting Principal Associate Commissioner for Policy.

[FR Doc. 2020–22901 Filed 10–16–20; 8:45 am]

BILLING CODE 4164–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9918]

RIN 1545–BO87

Effect of Section 67(g) on Trusts and Estates

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations clarifying that the following deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions: Costs paid or incurred in connection with the administration of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust, the personal exemption of an estate or non-grantor trust, the distribution deduction for trusts distributing current income, and the distribution deduction for estates and trusts accumulating income. Therefore, these deductions are not affected by the suspension of the deductibility of miscellaneous itemized deductions for taxable years beginning after December 31, 2017, and before January 1, 2026. The final regulations also provide guidance on determining the character, amount, and allocation of deductions in excess of gross income succeeded to by a beneficiary on the termination of an estate or non-grantor trust. The final regulations affect estates, non-grantor trusts (including the S portion of an electing small business trust), and their beneficiaries.

DATES:

Effective date: These regulations are effective on October 19, 2020.

Applicability dates: For dates of applicability, see §§ 1.67–4(d), 1.642(h)–2(f) and 1.642(h)–5(c).

FOR FURTHER INFORMATION CONTACT: Margaret Burow at (202) 317–5279 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to Income Tax Regulations (26 CFR part 1) under sections 67 and 642 of the Internal Revenue Code (Code). On May 11, 2020, the Department of Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG–113295–18) in the **Federal Register** (85 FR 27693) containing proposed regulations under sections 67 and 642(h) (proposed regulations). The Summary of Comments and Explanation of Revisions section of this preamble summarizes the provisions of sections 67 and 642(h) and the provisions of the proposed regulations, which are explained in greater detail in the preamble to the proposed regulations.

On July 17, 2020, the Treasury Department and the IRS published in the **Federal Register** (85 FR 43512) a notice of public hearing on the proposed regulations scheduled for August 12, 2020. The Treasury Department and the IRS received no requests to speak at a hearing in response to that notice. On August 5, 2020, the Treasury Department and the IRS published in the **Federal Register** (85 FR 47323) a cancellation of the notice of public hearing.

The Treasury Department and the IRS received written and electronic comments in response to the proposed regulations. All comments were considered and are available at *www.regulations.gov* or upon request. After full consideration of the comments received, this Treasury decision adopts the proposed regulations with modifications described in the Summary of Comments and Explanation of Revisions.

Summary of Comments and Explanation of Revisions

Most of the comments addressing the proposed regulations are summarized in this Summary of Comments and Explanation of Revisions. Comments merely summarizing or interpreting the proposed regulations or recommending statutory revisions are not discussed in this preamble. The Treasury Department and the IRS continue to study comments on issues related to sections 67 and 642(h) that are beyond the scope of these regulations, which may be discussed in future guidance if guidance on those issues is published. The scope of the proposed regulations and these regulations is limited to the effect of section 67(g) on the deductibility of certain expenses described in section 67(b) and (e) that are incurred by estates and non-grantor trusts and the treatment of excess deductions on termination of an estate or trust under section 642(h). This Summary of Comments and Explanation of Revisions also describes each of the final rules contained in this document.

A. Section 67

Section 67(g) was added to the Code on December 22, 2017, by section 11045(a) of Public Law 115–97, 131 Stat. 2054, 2088 (2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 67(g) prohibits individual taxpayers from claiming miscellaneous itemized deductions for any taxable year beginning after December 31, 2017, and before January 1, 2026. Prior to the TCJA, miscellaneous itemized deductions were allowable for any taxable year only to the extent that the sum of such deductions exceeded two percent of adjusted gross income. See section 67(a). Section 67(b) defines miscellaneous itemized deductions as itemized deductions other than those listed in section 67(b)(1) through (12).

Section 67(e) provides that, for purposes of section 67, an estate or trust computes its adjusted gross income in the same manner as that of an individual, except that the following additional deductions are treated as allowable in arriving at adjusted gross income: (1) The deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such estate or trust, and (2) deductions allowable under section 642(b) (concerning the personal exemption of an estate or non-grantor trust), section 651 (concerning the deduction for trusts distributing current income), and section 661 (concerning the deduction for estates and trusts accumulating income). Accordingly, section 67(e) removes the deductions described in section 67(e)(1) and (2) from the definition of itemized deductions under section 63(d), and thus from the definition of miscellaneous itemized deductions under section 67(b), and treats them as deductions allowable in arriving at adjusted gross income under section 62(a). Section 67(e) further provides regulatory authority to make appropriate adjustments in the application of part I of subchapter J of chapter 1 of the Code to take into account the provisions of section 67.

The proposed regulations under § 1.67–4 clarify that expenses described in section 67(e) remain deductible in determining the adjusted gross income of an estate or non-grantor trust during the taxable years in which section 67(g) applies. Accordingly, section 67(g) does not deny an estate or non-grantor trust (including the S portion of an electing small business trust) a deduction for expenses described in section 67(e)(1) and (2) because such deductions are allowable in arriving at adjusted gross income and are not miscellaneous itemized deductions under section 67(b). Commenters agreed with the proposed amendments. These regulations adopt the proposed regulations under § 1.67–4 without modification.

Two commenters requested that the regulations address the treatment of deductions described in section 67(e)(1) and (2) in determining an estate or non-grantor trust's income for alternative minimum tax (AMT) purposes. The commenters suggested that such deductions are allowable as deductible in computing the AMT. The treatment of deductions described in section 67(e) for purposes of determining the AMT is outside the scope of these regulations concerning the effects of section 67(g); therefore, these regulations do not address the AMT. Further, no conclusions should be drawn from the absence of a discussion of the AMT in these regulations regarding the treatment of deductions described in section 67(e) for purposes of determining the AMT.

One commenter suggested that the Treasury Department and the IRS exercise their regulatory authority under section 67(e) to exempt cemetery trusts under section 642(i) and qualified funeral trusts (QFTs) under section 685 from the application of section 67(g). The commenter stated that the primary type of expense incurred by these trusts is investment advisory expenses, the tax treatment of which differs under the Code from management expense. That is, trust management expenses generally are allowable in computing adjusted gross income under section 67(e)(1), while trust investment advisory expenses are miscellaneous itemized deductions. See § 1.67–4(b)(4). The commenter asserted that it was not the intent of Congress to disallow investment advisory expenses incurred by cemetery and funeral trusts when Congress enacted section 67(g).

The commenter suggested that exercising the regulatory authority under section 67(e) in this manner would be consistent with the exercise of regulatory authority under section 1411 to exempt section 642(i) cemetery perpetual care funds and QFTs. See § 1.1411–3(b)(1) (providing that certain types of trusts, including section 642(i) cemetery perpetual care funds, are excepted from the net investment income tax) and § 1.1411–3(b)(2) (providing a special rule for QFTs that, for purposes of calculating any tax under section 1411, section 1411 and the regulations thereunder are applied to each QFT by treating each beneficiary's interest in the trust as a separate trust). As stated in the preamble to TD 9644 (78 FR 72393), the Treasury Department and the IRS exercised their regulatory authority under section 1411 to exclude cemetery trusts from the net investment income tax because, by benefiting an operating company, such trusts are considered similar to the business trusts that are excluded from the operation of section 1411. The preamble also states that QFTs are not excluded from the application of the net income investment tax, but that the section 1411 tax is calculated consistent with the taxation of QFTs under chapter 1. The commenter noted that they advocated the treatment of each beneficiary's interest in the QFT as a separate trust because such treatment reduces the likelihood of the QFT beneficiaries being subject to the net investment income tax. The Treasury Department and the IRS continue to consider these comments but providing an exemption for cemetery and funeral trusts under section 67(g) is outside the scope of these regulations.

B. Section 642(h)

1. In General

Section 642(h) provides that if, on the termination of an estate or trust, the estate or trust has: (1) A net operating loss carryover under section 172 or a capital loss carryover under section 1212, or (2) for the last taxable year of the estate or trust, deductions (other than the deductions allowed under section 642(b) (relating to the personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income for such year, then such carryover or excess will be allowed as a deduction, in accordance with the regulations prescribed by the Secretary of the Treasury or his delegate (Secretary), to the beneficiaries succeeding to the property of the estate or trust.

Section 1.642(h)–2(a), as articulated in the proposed regulations and these final regulations, provides that if, on termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under section 642(b) or section 642(c)) in excess of gross income, the excess deductions are allowed under section 642(h)(2) as items of deduction to the beneficiaries succeeding to the property of the terminated estate or trust.

2. Character and Amount of Excess Deductions

Section 1.642(h)–2(b)(1) of the proposed regulations provides that each deduction comprising the excess deductions under section 642(h)(2) retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust. The character of these deductions does not change when succeeded to by a beneficiary on termination of the estate or trust. Furthermore, an item of deduction succeeded to by a beneficiary remains subject to any limitation applicable under the Code in the computation of the beneficiary's tax liability.

One commenter noted that section 642(h) states that excess deductions on termination of an estate or trust are to be ''allowed as a deduction, in accordance with regulations prescribed by the Secretary'' and that there is no express authority to treat excess deductions as miscellaneous or non-miscellaneous itemized deductions (or tax preference items for AMT purposes). The Treasury Department and the IRS disagree with this comment. The characterization of these excess deductions as a single miscellaneous itemized deduction in the current regulations was made before the enactment of section 67(g) and served as an administrative convenience. Making a change to that characterization is now appropriate to reflect the temporary disallowance of miscellaneous itemized deductions under section 67(g) since the regulations were written and is a proper exercise of the Secretary's specific grant of regulatory authority in section 642(h).

Another commenter requested that non-miscellaneous itemized deductions included in excess deductions be fully deductible by the beneficiary and not subject to a second level of limitation applicable on the beneficiary's return, because the amounts already would have been subject to limitation on the return of the estate or trust. The commenter provided an example of a terminated trust that paid $25,000 of state income tax, for which the trust is limited to a $10,000 deduction under section 164(b)(6)(B) for taxable years beginning after December 31, 2017, and before January 1, 2026. In the commenter's example, the entire amount of the allowable $10,000 deduction was passed through to the beneficiary as an excess deduction on termination of the trust. The excess of state income tax over the $10,000 limitation ($15,000) would not pass through as an excess deduction to the beneficiaries in this circumstance because the excess amount was not deductible to the trust. Excess state income tax on termination of the estate or trust may, however, pass through to a beneficiary if the estate or trust had insufficient income to absorb the entire $10,000 of state income tax deduction. In that circumstance, the commenter opined that the limitation under section 164(b)(6)(B), having already been applied at the trust level, should not again be applied at the beneficiary level. The Treasury Department and the IRS carefully considered the comment but determined that beneficiaries remain subject to the limitation in section 164(b)(6)(B). The Treasury Department and the IRS found no authority to exempt such items from the application of any limitations applicable to the beneficiary under the Code. The excess deductions retain their character in the hands of the beneficiary on termination of the trust, and all applicable limitations apply to all of the beneficiary's items of that character, regardless of their origin.

One commenter noted that, under § 1.641(c)–1(j), if an electing small business trust (ESBT) election terminates or is revoked and the S portion has a net operating loss or capital loss carryover or deductions in excess of gross income, then any such loss, carryover or excess deductions are allowed as a deduction, in accordance with the regulations under section 642(h), to the trust or to the beneficiaries succeeding to the property of the trust if the entire trust terminates. However, the commenter also noted that under the TCJA, section 641(c)(2)(E) was amended to provide that ESBT charitable contributions are deductible under section 170, rather than under section 642(c), so that, unlike other trust charitable deductions, an ESBT's charitable deduction could constitute part of the excess deductions on termination of the trust. The commenter stated that neither the legislative history nor the explanation of the staff of the Joint Committee on Taxation addressed whether this result was intended. The Treasury Department and the IRS note that charitable contribution deductions under both sections 170 and 642(c) are non-miscellaneous itemized deductions under sections 63(d) and 67(b)(4) to the estate or trust and maintain that such character is retained in the hands of the beneficiary in these regulations. Although the Treasury Department and the IRS continue to consider the application of section 170 to ESBT charitable contributions under section 641(c)(2)(E), this issue is outside the scope of these regulations.

Another commenter requested clarification of whether an excess deduction on termination of a trust or estate that is allowed in determining the net investment income under section 1411 of the estate or trust remains deductible in the hands of the beneficiary in determining the net investment income of the beneficiary under section 1411. These final regulations provide that each excess deduction retains its separate character as a section 67(e) deduction, non-miscellaneous itemized deduction, or miscellaneous itemized deduction in the hands of the beneficiary. Whether a deduction retains its character as allowable in computing the net investment income of the beneficiary, however, is outside the scope of these regulations.

3. Reporting of Excess Deductions

Section 1.642(h)–2(b)(1) of the proposed regulations provides that an item of deduction succeeded to by a beneficiary remains subject to any additional applicable limitation under the Code and must be separately stated if it could be so limited, as provided in the instructions to Form 1041, *U.S. Income Tax Return for Estates and Trusts,* and the Schedule K–1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credit, etc.* Commenters requested that the Treasury Department and the IRS provide guidance on how the excess deductions are to be reported by both the terminated estate or trust and by its beneficiaries. The Treasury Department and the IRS released instructions for beneficiaries that chose to claim excess deductions on Form 1040 in the 2019 or 2018 taxable year based on the proposed regulations. In addition, the Treasury Department and the IRS plan to update the instructions for Form 1041, Schedule K–1 (Form 1041), and Form 1040, *U.S. Individual Income Tax Return,* for the 2020 and subsequent tax years to provide for the reporting of excess deductions that are section 67(e) expenses or non-miscellaneous itemized deductions.

The Treasury Department and the IRS are aware that the income tax laws of some U.S. states do not conform to the Code with respect to section 67(g), such that beneficiaries may need information on miscellaneous itemized deductions of a terminated estate or trust. However, because miscellaneous itemized deductions are currently not allowed for Federal income tax purposes, that information is not needed for Federal income tax purposes. Therefore, it would not be appropriate to modify Federal income tax forms to require or accommodate the collection of such information while this deduction is suspended. Estates, trusts, and beneficiaries are advised to consult the relevant state taxing authority for information about deducting miscellaneous itemized expenses on their state tax returns.

4. Determinations of Deductions in Year of Termination of the Trust

Section 1.642(h)–2(b)(2) of the proposed regulations provides that the provisions of § 1.652(b)–3 are used to allocate each item of deduction among the classes of income in the year of termination for purposes of determining the character and amount of the excess deductions under section 642(h)(2). Accordingly, the amount of each separate deduction remaining after application of § 1.652(b)–3 comprises the excess deductions available to the beneficiaries succeeding to the property of the estate or trust as provided under section 642(h)(2). In addition, as previously explained, an item of deduction succeeded to by a beneficiary remains subject to any additional applicable limitation under the Code. Furthermore, § 1.642(h)–2(c) of the proposed regulations provides that excess deductions are allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates. That is, excess deductions of a terminated estate or trust may not carry over to a subsequent year of the beneficiary.

One commenter requested that these regulations provide an ordering rule clarifying whether excess deductions on termination of a trust allowed as a deduction to the beneficiary are claimed before, after, or ratably with the beneficiary's other deductions, particularly when the amount of the excess deductions and other deductions exceed the beneficiary's gross income. These final regulations clarify that beneficiaries may claim all or part of the excess deductions under section 642(h)(2) before, after, or together with the same character of deductions separately allowable to the beneficiary under the Code.

That commenter also requested that the final regulations include an exception for investment interest expense under section 163(d) from the general rule that excess deductions on termination of a trust or estate may be claimed only in the beneficiary's taxable year during which the trust or estate terminated. That section permits the carryforward of investment interest under section 163(d)(2) to the taxpayer's subsequent taxable years if the taxpayer is unable to deduct the investment interest in the current taxable year. The commenter stated that the disallowance of the carryover of section 642(h)(2) excess deductions should not apply to those excess deductions that are no longer treated as miscellaneous itemized deductions under the proposed regulations, and that carryover should be permitted to the extent otherwise permitted under the Code. The preamble to the proposed regulations states that addressing suspended deductions under section 163(d) is beyond the scope of the regulations and the same is true of these final regulations.

A commenter requested that the amount of a beneficiary's net operating loss carryover to a later taxable year under section 172 should include all of the beneficiary's section 642(h)(2) excess deductions that are section 67(e) deductions, as deductions that are attributable to the beneficiary's trade or business and thus deductions attributable to a trade or business under section 172(d)(4). Section 642(h) makes it clear that a net operating loss carryover under paragraph (1) of that section is separate and distinct from the excess deductions on termination described in paragraph (2) of that section. Furthermore, § 1.642(h)–2(d) provides that a deduction based upon a net operating loss carryover generally will not be allowed to beneficiaries under both paragraphs (1) and (2) of section 642(h). Therefore, an excess deduction allowable to the beneficiary under section 642(h)(2) is not a net operating loss carryover succeeded to by the beneficiary under section 642(h)(1) and (with one exception) a net operating loss carryover is not an excess deduction on termination. Moreover, these regulations provide that it is the character of the excess deductions as section 67(e) deductions, non-miscellaneous itemized deductions, and miscellaneous itemized deductions, and not the character of a deduction as attributable to a trade or business, that is retained in the hands of the beneficiary. Thus, whether section 642(h)(2) excess deductions that are section 67(e) deductions may be included in a beneficiary's net operating loss carryovers under section 172, separate from those it succeeds to from a terminated estate or trust, is beyond the scope of these regulations. Because § 1.642(h)–2(a) is clear that excess deductions on termination of an estate or trust are not carried over to future years and that such deductions are separate from a net operating loss carryover from the estate or trust, the Treasury Department and the IRS do not adopt this comment.

6. Example 1

Section 1.642(h)–5(a), *Example 1,* of the proposed regulations (*Example 1*) updates an existing example illustrating computations under section 642(h) when there is a net operating loss. Section 1.642–5(a)(2)(ii) of *Example 1* explains that the beneficiaries of the trust cannot carry back any of the net operating loss of the terminating estate that was made available to them under section 642(h)(1).

Two commenters requested that *Example 1* be revised to take into account the amendments to section 172(b)(1)(D) under sec. 2302(b) of the Coronavirus Aid, Relief, and Economic Security Act, Public Law 116–136, 134 Stat. 281 (2020) (CARES Act), by allowing a beneficiary to carry back the net operating loss carryover the beneficiary succeeds to under section 642(h)(1) for net operating losses arising in taxable years beginning after December 31, 2017, and before January 1, 2021. Under section 2303 of the CARES Act, net operating losses arising in taxable years beginning after December 31, 2017, and before January 1, 2021, generally may be carried back five years before being carried forward. One of these commenters further requested confirmation that a beneficiary is allowed a carryback of the net operating loss under section 642(h)(1) for net operating losses of an estate or trust arising in taxable years ending before January 1, 2018, to the extent the beneficiary succeeds to a net operating loss carryover attributable to those net operating losses on a termination of the estate or trust between January 1, 2018, and December 31, 2020.

Unless otherwise provided under the Code, a net operating loss incurred by a taxpayer may only be used as a deduction by that taxpayer and cannot be transferred to another taxpayer for use by that other taxpayer. *Calvin* v. *U.S.* 354 F.2d 202 (10th Cir. 1965), *Mellott* v. *U.S.,* 257 F.2d 798 (3d Cir. 1958). As an exception to this general principle, section 642(h) provides that if, on termination of an estate or trust, the estate or trust has a net operating loss carryover under section 172, then such carryover is allowed as a deduction, in accordance with the regulations prescribed by the Secretary, to the beneficiaries succeeding to the property of the estate or trust. Section 1.642(h)–1(a) provides that if, on the termination of an estate or trust, a net operating loss carryover under section 172 would be allowable to the estate or trust in a taxable year subsequent to the taxable year of termination but for the termination, a carryover is allowed under section 642(h)(1) to the beneficiaries succeeding to the property of the estate or trust. In addition, § 1.642(h)–1(b) provides that the first taxable year of the beneficiary to which the net operating loss will be carried over is the taxable year of the beneficiary in which or with which the estate or trust terminates.

Section 642(h)(1) provides a specific rule that allows the beneficiary to succeed to a net operating loss carryover of the estate or trust and deduct the amount of the net operating loss over the remaining carryover period that would have been allowable to the estate or trust but for the termination of the estate or trust. The phrase in section 642(h)(1) ''the estate or trust has a net operating loss *carryover*'' means that the estate or trust incurred a net operating loss and either already carried it back to the earliest allowable year under section 172 or elected to waive the carryback period under section 172(b)(3), and now is limited to carrying over the remaining net operating loss. Accordingly, because the net operating loss is a carryover for the estate or trust, the beneficiary succeeding to that net operating loss may, under section 642(h)(1), only carry it forward.

The CARES Act amendments to section 172(b) mentioned by the commenters allow taxpayers a five-year carryback of certain net operating losses incurred by that taxpayer. The CARES Act amendments do not change the result that a beneficiary succeeding to the net operating loss carryover of a terminated estate or trust may only carryover that net operating loss in the same manner as the terminated estate or trust, but for the termination. Consequently, the Treasury Department and the IRS do not adopt these comments and add a citation to § 1.642(h)–1 to reference the rule that a beneficiary that succeeds to a net operating loss carryover of a terminated estate or trust may only carry forward the net operating loss.

7. Example 2

Section § 1.642(h)–5(b), *Example 2,* of the proposed regulations (*Example 2*) demonstrates computations under section 642(h)(2). The expenses in *Example 2* include rental real estate taxes in an attempt to illustrate a deduction subject to limitation under section 164(b)(6) to the beneficiary that must be separately stated as provided in § 1.642(h)–2(b)(1).

Multiple commenters noted that *Example 2* raises several issues that could be potentially relevant to that example, such as whether the decedent was in a trade or business and the application of section 469 to estates and trusts. To avoid these issues, which are extraneous to the point being illustrated, one commenter suggested that the example be revised so that the entire amount of real estate expenses on rental property equals the amount of rental income. The Treasury Department and the IRS did not intend to raise such issues in the example and consider both issues to be outside the scope of these regulations. Accordingly, the Treasury Department and the IRS adopt the suggestion by the commenter and modify *Example 2* to avoid these issues by having rental real estate expenses entirely offset rental income with no unused deduction.

Commenters also noted that *Example 2* does not properly allocate rental real estate expenses because the example characterizes the rental real estate taxes as itemized deductions. These commenters asserted that real estate taxes on property held for the production of rental income are not itemized deductions but instead are allowed in computing gross income and cited to section 62(a)(4) as providing that ordinary and necessary expenses paid or incurred during the taxable year for the management, conservation, or maintenance of property held for the production of income under section 212(2) that are attributable to property held for the production of rents are deductible as above-the-line deductions in arriving at adjusted gross income. One commenter suggested that, if the goal of *Example 2* is to illustrate state and local taxes passing through to the beneficiary, then the example should include state income taxes rather than real estate taxes on rental real estate. The Treasury Department and the IRS have revised this example in the final regulations to include personal property tax paid by the trust rather than taxes attributable to rental real estate.

Lastly, commenters noted that *Example 2* does not demonstrate the broad range of trustee discretion in § 1.652(b)–3(b) and (d) for deductions that are not directly attributable to a class of income, or deductions that are, but which exceed such class of income, respectively. In response to these comments, the Treasury Department and the IRS have modified *Example 2* to illustrate the application of trustee discretion as found in § 1.652(b)–3(b) and (d).

C. Applicability Dates

The proposed regulations provide that the changes to §§ 1.67–4, 1.642(h)–2, and 1.642(h)–5 apply to taxable years beginning after the date the regulations are published as final. The preamble to the proposed regulations explains that estates, non-grantor trusts, and their beneficiaries may rely on the proposed regulations under section 67 for taxable years beginning after December 31, 2017, and on or before the date these regulations are published as final. Taxpayers may also rely on the proposed regulations under section 642(h) for taxable years of beneficiaries beginning after December 31, 2017, and on or before the date the regulations are published as final, in which an estate or trust terminates.

One commenter requested that § 1.642(h)–2 of the proposed regulations be applied retroactively not only to taxable years beginning after December 31, 2017, but to all open years. The commenter asserted that the existing regulation treating excess deductions on termination of an estate as a miscellaneous itemized deduction was in error. As an example, the commenter argues that the current regulations mistakenly describe section 67(e) expenses as an exception to the rules applicable to miscellaneous itemized deductions, and therefore requested that the final regulations be applicable to all open years. The Treasury Department and the IRS have the authority to treat an excess deduction on termination of an estate or trust as a single miscellaneous itemized deduction. See section 642(h). The suspension under section 67(g) of miscellaneous itemized deductions caused the Treasury Department and the IRS to reconsider the treatment of excess deductions under section 642(h)(2) because the Treasury Department and the IRS do not interpret section 67(g) as suspending such deductions allowable under section 642(h)(2). The Treasury Department and the IRS interpret section 67(g) as not disallowing excess deductions succeeded to beneficiaries from terminated estates and trusts under section 642(h)(2). Therefore, taxpayers may rely on these regulations as of the effective date of section 67(g), but not for earlier periods.

The final regulations apply to taxable years beginning after October 19, 2020. Pursuant to section 7805(b)(7), taxpayers may choose to apply the amendments to § 1.67–4 and §§ 1.642(h)–2 and 1.642(h)–5 set forth in this Treasury decision to taxable years beginning after December 31, 2017, and on or before October 19, 2020.

Special Analysis

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

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to report the required information will be minimal in that it requires fiduciaries of estates and trusts to provide on the Schedule K–1 (Form 1041) issued to beneficiaries information that is already maintained and reported to the IRS on Form 1041. Moreover, it should take an estate or trust no more than 2 hours to satisfy the information requirement in these regulations. Accordingly, the

Secretary certifies that the rule will not have a significant economic impact on a substantial number of small entities.

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

Paperwork Reduction Act (PRA)

The collection of information related to these regulations under section 642(h) is reported on Schedule K–1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credits, etc.,* and has been reviewed in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) and approved by the Office of Management and Budget under control number 1545–0092.

The collection of information in these regulations is in § 1.642(h)–2(b)(1). The IRS requires this information to ensure that excess deductions on an estate's or trust's termination that are subject to additional applicable limitations retain their character when taken into account by beneficiaries on their returns. The respondents will be estates, trusts, and their fiduciaries.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

Drafting Information

The principal author of these regulations is Margaret Burow of the Office of Associate Chief Counsel (Passthroughs and Special Industries). Other personnel from the Treasury Department and the IRS, however, participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding entries for §§ 1.67–4, 1.642(h)–2, and 1.642(h)–5 in numerical order to read in part as follows:

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

Section 1.67–4 also issued under 26 U.S.C. 67(e).

* * * * *

Section 1.642(h)–2 also issued under 26 U.S.C. 642(h).

Section 1.642(h)–5 also issued under 26 U.S.C. 642(h).

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■ **Par. 2.** Section 1.67–4 is amended by revising paragraph (a) and the heading of paragraph (d) and adding two sentences to the end of paragraph (d) to read as follows:

§ 1.67–4 Costs paid or incurred by estates or non-grantor trusts.

(a) *Deductions*—(1) *Section 67(e) deductions*—(i) *In general.* An estate or trust (including the S portion of an electing small business trust) not described in § 1.67–2T(g)(1)(i) (a non-grantor trust) must compute its adjusted gross income in the same manner as an individual, except that the following deductions (section 67(e) deductions) are allowed in arriving at adjusted gross income:

(A) Costs that are paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in such estate or trust; and

(B) Deductions allowable under section 642(b) (relating to the personal exemption) and sections 651 and 661 (relating to distributions).

(ii) *Not disallowed under section 67(g).* Section 67(e) deductions are not itemized deductions under section 63(d) and are not miscellaneous itemized deductions under section 67(b). Therefore, section 67(e) deductions are not disallowed under section 67(g).

(2) *Deductions subject to 2-percent floor.* A cost is not a section 67(e) deduction and thus is subject to both the 2-percent floor in section 67(a) and section 67(g) to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust (including the S portion of an electing small business trust), and commonly or customarily would be incurred by a hypothetical individual holding the same property.

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(d) *Applicability date.* * * * Paragraph (a) of this section applies to taxable years beginning after October 19, 2020. Taxpayers may choose to apply paragraph (a) of this section to taxable years beginning after December 31, 2017, and on or before October 19, 2020.

■ **Par. 3.** Section 1.642(h)–2 is amended by:

■ 1. Revising paragraph (a).

■ 2. Redesignating paragraph (b) as paragraph (d) and adding a heading for newly redesignated paragraph (d).

■ 3. Redesignating paragraph (c) as paragraph (e) and adding a heading for newly redesignated paragraph (e).

■ 4. Adding new paragraphs (b) and (c) and paragraph (f).

The revisions and additions read as follows:

§ 1.642(h)–2 Excess deductions on termination of an estate or trust.

(a) *Excess deductions*—(1) *In general.* If, on the termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under section 642(b) (relating to the personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income, the excess deductions as determined under paragraph (b) of this section are allowed under section 642(h)(2) as items of deduction to the beneficiaries succeeding to the property of the estate or trust.

(2) *Treatment by beneficiary.* A beneficiary may claim all or part of the amount of the deductions provided for in paragraph (a) of this section, as determined after application of paragraph (b) of this section, before, after, or together with the same character of deductions separately allowable to the beneficiary under the Internal Revenue Code for the beneficiary's taxable year during which the estate or trust terminated as provided in paragraph (c) of this section.

(b) *Character and amount of excess deductions*—(1) *Character.* The character and amount of the excess deductions on termination of an estate or trust will be determined as provided in this paragraph (b). Each deduction comprising the excess deductions under section 642(h)(2) retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust. An item of deduction succeeded to by a beneficiary remains subject to any additional applicable limitation under the Internal Revenue Code and must be separately stated if it could be so limited, as provided in the instructions to Form 1041, *U.S. Income Tax Return for Estates and Trusts,* and the Schedule K–1 (Form 1041), *Beneficiary's Share of Income, Deductions, Credit, etc.,* or successor forms.

(2) *Amount.* The amount of the excess deductions in the final year is determined as follows:

(i) Each deduction directly attributable to a class of income is allocated in accordance with the provisions in § 1.652(b)–3(a);

(ii) To the extent of any remaining income after application of paragraph (b)(2)(i) of this section, deductions are allocated in accordance with the provisions in § 1.652(b)–3(b) and (d); and

(iii) Deductions remaining after the application of paragraph (b)(2)(i) and (ii) of this section comprise the excess deductions on termination of the estate or trust. These deductions are allocated to the beneficiaries succeeding to the property of the estate of or trust in accordance with § 1.642(h)–4.

(c) *Year of termination*—(1) *In general.* The deductions provided for in paragraph (a) of this section are allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates, whether the year of termination of the estate or trust is of normal duration or is a short taxable year.

(2) *Example.* Assume that a trust distributes all its assets to B and terminates on December 31, Year X. As of that date, it has excess deductions of $18,000, all characterized as allowable in arriving at adjusted gross income under section 67(e). B, who reports on the calendar year basis, could claim the $18,000 as a deduction allowable in arriving at B's adjusted gross income for Year X. However, if the deduction (when added to other allowable deductions that B claims for the year) exceeds B's gross income, the excess may not be carried over to any year subsequent to Year X.

(d) *Net operating loss carryovers.* * * *

(e) *Items included in net operating loss or capital loss carryovers.* * * *

(f) *Applicability date.* Paragraphs (a) through (c) of this section apply to taxable years beginning after October 19, 2020. The rules applicable to taxable years beginning on or before October 19, 2020 are contained in § 1.642(h)-2 as in effect prior to October 19, 2020 (see 26 CFR part 1 revised as of April 1, 2020). Taxpayers may choose to apply paragraphs (a) through (c) of this section to taxable years beginning after December 31, 2017, and on or before October 19, 2020.

■ **Par. 4.** Section 1.642(h)–5 is revised to read as follows:

§ 1.642(h)–5 Examples.

Paragraphs (a) and (b) of this section (*Examples 1* and *2*) illustrate the application of section 642(h).

(a) *Example 1: Computations under section 642(h) when an estate has a net operating loss*—(1) *Facts.* On January 31, 2020, A dies leaving a will that provides for the distribution of all of A's estate equally to B and an existing trust for C. The period of administration of the estate terminates on December 31, 2020, at which time all the property of the estate is distributed to B and the trust. For tax purposes, B and the trust report income on a calendar year basis. During the period of administration, the estate has the following items of income and deductions:

TABLE 1 TO PARAGRAPH (a)(1)

Income:	
Taxable interest	$2,500
Business income	3,000
Total income	5,500

TABLE 2 TO PARAGRAPH (a)(1)

Deductions:	
Business expenses (including administrative expense allocable to business income)	5,000
Administrative expenses not allocable to business income that would not have been incurred if property had not been held in a trust or estate (section 67(e) deductions)	9,800
Total deductions	14,800

(2) *Computation of net operating loss.* (i) The amount of the net operating loss carryover is computed as follows:

TABLE 3 TO PARAGRAPH (a)(2)(i)

Gross income	$5,500
Total deductions	14,800
Less adjustment under section 172(d)(4) (allowable non-business expenses ($9,800) limited to non-business income ($2,500))	7,300
Deductions as adjusted	7,500
Net operating loss	2,000

(ii) Under section 642(h)(1), B and the trust are each allocated $1,000 of the $2,000 unused net operating loss carryover of the terminated estate in 2020, with the allowance of any net operating loss carryover to B and the trust determined under section 172. Neither B nor the trust can carry back any of the net operating loss of A's estate made available to them under section 642(h)(1). *See* § 1.642(h)–1(b).

(3) *Section 642(h)(2) excess deductions.* The $7,300 of non-business deductions not taken into account in

determining the net operating loss of the estate are excess deductions on termination of the estate under section 642(h)(2). Under § 1.642(h)–2(b)(1), such deductions retain their character as section 67(e) deductions. Under § 1.642(h)–4, B and the trust each are allocated $3,650 of excess deductions based on B's and the trust's respective shares of the burden of each cost.

(4) *Consequences for C.* The net operating loss carryover and excess deductions are not allowable directly to C, the trust beneficiary. To the extent the distributable net income of the trust is reduced by the net operating loss carryover and excess deductions, however, C may receive an indirect benefit from the carryover and excess deductions.

(b) *Example 2: Computations under section 642(h)(2)*—(1) *Facts.* D dies in 2019 leaving an estate of which the residuary legatees are E (75%) and F (25%). The estate's income and deductions in its final year are as follows:

TABLE 4 TO PARAGRAPH (b)(1)

Income:	
Dividends	$3,000
Taxable Interest	500
Rent	2,000
Capital Gain	1,000
Total Income	6,500

TABLE 5 TO PARAGRAPH (b)(1)

Deductions:	
Section 62(a)(4) deductions:	
Rental real estate expenses	2,000
Section 67(e) deductions:	
Probate fees	1,500
Estate tax preparation fees	8,000
Legal fees	2,500
Total Section 67(e) deductions	12,000
Non-miscellaneous itemized deductions:	
Personal property taxes	3,500
Total deductions	17,500

(2) *Determination of character.* Pursuant to § 1.642(h)–2(b)(2), the character and amount of the excess deductions is determined by allocating the deductions among the estate's items of income as provided under § 1.652(b)–3. Under § 1.652(b)–3(a), the $2,000 of rental real estate expenses is allocated to the $2,000 of rental income. In the exercise of the executor's discretion pursuant to § 1.652(b)–3(b), D's executor allocates $3,500 of personal property taxes and $1,000 of section 67(e) deductions to the remaining income. As a result, the excess deductions on termination of the estate are $11,000, all consisting of section 67(e) deductions.

(3) *Allocations among beneficiaries.* Pursuant to § 1.642(h)–4, the excess deductions are allocated in accordance with E's (75 percent) and F's (25 percent) interests in the residuary estate. E's share of the excess deductions is $8,250, all consisting of section 67(e) deductions. F's share of the excess deductions is $2,750, also all consisting of section 67(e) deductions.

(4) *Separate statement.* If the executor instead allocated $4,500 of section 67(e) deductions to the remaining income of the estate, the excess deductions on termination of the estate would be $11,000, consisting of $7,500 of section 67(e) deductions and $3,500 of personal property taxes. The non-miscellaneous itemized deduction for personal property taxes may be subject to limitation on the returns of both B and C's trust under section 164(b)(6)(B) and would have to be separately stated as provided in § 1.642(h)–2(b)(1).

(c) *Applicability date.* This section is applicable to taxable years beginning after October 19, 2020. Taxpayers may choose to apply this section to taxable years beginning after December 31, 2017, and on or before October 19, 2020.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

Approved: September 16, 2020.

David J. Kautter,

Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF JUSTICE

Bureau of Prisons

28 CFR Part 541

[Docket No. BOP–1172–F]

RIN 1120–AB72

Inmate Discipline Program: New Prohibited Act Code for Pressuring Inmates for Legal Documents.

AGENCY: Bureau of Prisons, Department of Justice.

ACTION: Final rule.

SUMMARY: In this document, the Bureau of Prisons (Bureau) adds a new code to the list of prohibited act codes in the inmate discipline regulations which will clarify that the Bureau may discipline inmates for pressuring or otherwise intimidating other inmates into producing copies of their own legal documents, such as pre-sentence reports (PSRs), or statement of reasons (SORs).

DATES: This rule is effective November 18, 2020.

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