

(e) *Substantial tax reduction requirement*—(1) *General rule.* The determination of whether there is a strong likelihood that the failure to treat a noncompensatory option holder as a partner would result in a substantial reduction in the present value of the partners' and the noncompensatory option holder's aggregate Federal tax liabilities is based on all the facts and circumstances, including—

(i) The interaction of the allocations of the issuing partnership and the partners' and noncompensatory option holder's Federal tax attributes (taking into account tax consequences that result from the interaction of the allocations with the partners' and noncompensatory option holder's Federal tax attributes that are unrelated to the partnership);

(ii) The absolute amount of the Federal tax reduction;

(iii) The amount of the reduction relative to overall Federal tax liability; and

(iv) The timing of items of income and deductions.

(2) *Special rules.* For purposes of applying paragraph (e)(1) of this section to a partner or noncompensatory option holder that is—

(i) A look-through entity (as defined in paragraph (b)(1) of this section), the Federal tax consequences that result from the interaction of allocations of the partnership and the Federal tax attributes of any person that is an owner, or in the case of a trust or estate, the beneficiary, of an interest in such a partner or noncompensatory option holder, whether directly, or indirectly through one or more look-through entities, must be taken into account; or

(ii) A member of a consolidated group (within the meaning of §1.1502-1(h)), the tax consequences that result from the interaction of the issuing partnership's allocations and the tax attributes of the consolidated group and the tax attributes of another member with respect to a separate return year must be taken into account.

(f) *Example.* The following example illustrates the provisions of this section. For purposes of the example, assume that PRS is a partnership for Federal tax purposes, none of the noncompensatory option holders or partners are

related persons, and that general principles of law do not apply to treat the noncompensatory option as a partnership interest. The example reads as follows:

*Example. Active trade or business.* PRS is engaged in an active real estate business, the amount of income, gain, loss, and deductions from which cannot be predicted with any reasonable certainty. In exchange for a premium of \$10x, PRS issues a noncompensatory option to A to acquire a 10 percent interest in PRS for \$110x at any time during a 3-year period commencing on the date on which the option is issued. At the time of the issuance of the noncompensatory option, a 10 percent interest in PRS has a fair market value of \$100x. Due to the nature of PRS's business, the value of a 10 percent PRS interest in 3 years is not reasonably predictable as of the time the noncompensatory option is issued. Assuming there are no other facts affecting the certainty of the option's exercise, it is not reasonably certain that A's option will be exercised. Therefore, assuming that A does not possess partner attributes as described in paragraph (d)(3) of this section, A's noncompensatory option is not treated as a partnership interest under paragraph (a)(1) of this section.

(g) *Effective/applicability date.* This section applies to noncompensatory options issued on or after February 5, 2013.

[T.D. 9612, 78 FR 8013, Feb. 5, 2013, as amended at 78 FR 17869, Mar. 25, 2013]

EFFECTIVE DATE FOR SUBCHAPTER K,  
CHAPTER 1 OF THE CODE

**§ 1.771-1 Effective date.**

(a) *General rule.* Except as provided in paragraph (b) or (c) of this section, the provisions of subchapter K, chapter 1 of the Code, shall apply to any taxable year of a partnership beginning after December 31, 1954, and to any part of a partner's taxable year falling within such partnership taxable year. The provisions of the Internal Revenue Code of 1939 relating to partnerships shall apply to any taxable year of a partnership beginning before January 1, 1955, and to any part of a partner's taxable year falling within such partnership taxable year. If a partnership and the partners are on different taxable years, subchapter K shall become effective at the same time both for the partnership and for the partners.

(b) *Special rules.* Certain provisions of section 771 apply after specific dates in 1954, as follows:

(1) *Adoption of taxable year.* Section 706(b) (relating to the adoption of taxable years by partners and partnerships), shall apply to any partnership which adopts or changes to, and any partner who changes to, a taxable year beginning on or after April 2, 1954. For the purpose of applying this subparagraph, the rules of section 708 (relating to the continuation of partnerships) shall apply. For example, if two or more partnerships merge after April 1, 1954, and the new partnership uses the taxable year of the partnership of which it is deemed to be the successor under section 708(b)(2)(A), it will not need prior approval to continue to use such taxable year even though such year may be different from the taxable years of the partners. Such a partnership is not "adopting" or "changing" its taxable year.

(2) *Property distributed by a partnership.* Section 735(a), relating to the character of gain or loss on disposition of property distributed by a partnership to a partner, shall apply only to property distributed after March 9, 1954. Although a partnership whose taxable year begins before January 1, 1955, generally will be subject to the provisions of the Internal Revenue Code of 1939, any unrealized receivables or inventory items distributed by any such partnership after March 9, 1954, will be subject to the provisions of section 735(a), and the gain or loss on the subsequent disposition of such property will be ordinary gain or loss rather than capital gain or loss. In the case of property distributed before March 10, 1954, section 735(a) will not apply, even though the property is disposed of by the distributee partner after that date, unless the partnership elects under paragraph (c) of this section to apply section 735.

(3) *Unrealized receivables and inventory items.* Section 751 (providing for the realization of ordinary income on certain transfers or distributions of unrealized receivables or substantially appreciated inventory items) shall be applicable to any such transfer or distribution occurring after March 9, 1954. For the purpose of applying section 751 in

the case of a taxable year beginning before January 1, 1955, a partnership or partner may elect to treat as applicable any other section of subchapter K. See paragraph (f) of §1.751-1.

(4) *Partner receiving income in respect of a decedent.* Section 753, which provides that the amount includible in the gross income of a successor in interest of a deceased partner under section 736(a) shall be considered income in respect of a decedent under section 691, shall apply only in the case of payments made with respect to decedents whose death occurred after December 31, 1954.

(c) *Optional treatment of certain distributions.* (1) For a partnership taxable year beginning after December 31, 1953, and before January 1, 1955, a partnership may elect to apply the rules of certain sections of subchapter K with respect to current distributions made by the partnership in such year. These sections are 731, 732 (a), (c), and (e), 733, 735, and 751 (b), (c), and (d). If an election is made, it shall apply to the partnership and all its members for all current distributions made by the partnership during the taxable year. Such distributions shall also be subject to the rules of section 705 (relating to determination of basis of a partner's interest), 752 (relating to treatment of certain liabilities), and 761(d) (relating to the definition of liquidation of a partner's interest), to the extent that such sections apply to current distributions.

(2) An election under this paragraph shall be made by a statement filed with the partnership return for the taxable year to which such election applies, or before August 23, 1956, whichever date is later. The statement shall be signed by all members of the partnership and the election once made shall be binding on the partnership and on all of its members.

#### INSURANCE COMPANIES

#### LIFE INSURANCE COMPANIES

#### DEFINITION; TAX IMPOSED

#### § 1.801-1 Definitions.

(a) *Life insurance company.* The term *life insurance company* as used in subtitle A of the Code is defined in section 801. For the purpose of determining