actually commenced on the retroactive annuity starting date.

(v) *Requirements applicable to retroactive annuity starting dates.* A distribution is permitted to have a retroactive annuity starting date with respect to a participant's benefit only if the following requirements are met:

(A) The participant's spouse (including an alternate payee who is treated as the spouse under a qualified domestic relations order (QDRO), as defined in section 414(p)), determined as if the date distributions commence were the participant's annuity starting date, consents to the distribution in a manner that would satisfy the requirements of section 417(a)(2). The spousal consent requirement of this paragraph (b)(3)(v)(A) is satisfied if such spouse consents to the distribution under paragraph (b)(2)(i) of this section. The spousal consent requirement of this paragraph (b)(3)(v)(A) does not apply if the amount of such spouse's survivor annuity payments under the retroactive annuity starting date election is no less than the amount that the payments to such spouse would have been under a QJSA with an annuity starting date after the date that the explanation was provided.

(B) The distribution (including appropriate interest adjustments) provided based on the retroactive annuity starting date would satisfy the requirements of sections 417(e)(3), if applicable, and section 415 if the date the distribution commences is substituted for the annuity starting date for all purposes, including for purposes of determining the applicable interest rate and the applicable mortality table.

(vi) *Timing of notice and consent requirements in the case of retroactive annuity starting dates.* In the case of a retroactive annuity starting date, the date of the first actual payment of benefits based on the retroactive annuity starting date is substituted for the annuity starting date for purposes of satisfying the timing requirements for giving consent and providing an explanation of the QJSA provided in paragraphs (b)(3)(i) and (ii) of this section, except that the substitution does not apply for purposes of paragraph (b)(3)(iii) of this section. Thus, the written explanation required by section 417(a)(3)(A) must generally be provided no less than 30 days and no more than 90 days before the date of the first payment of benefits and the election to receive the distribution must be made after the written explanation is provided and on or before the date of the first payment. Similarly, the written explanation may also be provided less than 30 days prior to the first payment of benefits if the requirements of paragraph (b)(3)(ii) of this section would be satisfied if the date of the first payment is substituted for the annuity starting date.

(vii) *Administrative delay.* A plan will not fail to satisfy the 90-day timing requirements of paragraphs (b)(3)(iii) and (vi) of this section merely because, due solely to administrative delay, a distribution commences more than 90 days after the written explanation of the QJSA is provided to the participant.

* * * * *

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

[FR Doc. 01–132 Filed 1–16–01; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–104876–00]

RIN 1545–AY66

Taxable Years of Partner and Partnership; Foreign Partners

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations on the taxable year of a partnership with foreign partners. The proposed regulations affect partnerships and their partners. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by April 17, 2001. Requests to speak (with outlines of oral comments) at the public hearing scheduled for June 6, 2001, at 10 a.m., must be submitted by May 16, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–104876–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–104876–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option of the IRS Home Page or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax__regs/regslist.html. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Dan Carmody, (202) 622–3080; concerning specific international issues, Ronald M. Gootzeit, (202) 622–3860; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION: This document proposes to amend section 706 of the Income Tax Regulations (26 CFR part 1) regarding partnership taxable years.

Background

Section 706 governs the taxable years for a partnership and its partners. The partners and the partnership each have their own taxable years, which may or may not coincide. Under section 706(a), for a partner's taxable year, the partner must include in taxable income the partner's share of any income, gain, loss, deduction, or credit of the partnership for the partnership's taxable year that ends within or with the partner's taxable year. Section 706(b) provides rules for determining a partnership's taxable year.

Prior to the Tax Reform Act of 1986, it was possible for partners to create income deferral opportunities through arranging divergent taxable years for a partnership and its partners. For example, under certain circumstances, a partnership could elect a June 30 taxable year while its partners were calendar year taxpayers. Under such an arrangement, the partners would include partnership income earned from July 1, Year 1, to June 30, Year 2, in Year 2, when the partnership's taxable year ended, even though six months of income was generated during Year 1. To prevent this potential for income deferral, Congress amended section 706(b). See generally Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986, 533–39 (1986).*

Section 706(b) provides that, unless the partnership establishes a business purpose for a different taxable year, a partnership cannot have a taxable year other than: (i) the majority interest taxable year; (ii) if there is no majority interest taxable year, the taxable year of all the principal partners of the partnership; or (iii) if there is no taxable year described in (i) or (ii), the calendar year unless the Secretary by regulation prescribes another period. Section

1.706–1T(a)(1) and (2) provides that if neither (i) nor (ii) is applicable, the partnership's taxable year will be the taxable year that results in the least aggregate deferral of partnership income.

Additionally, § 1.706–3T(a) provides that under certain circumstances, a tax-exempt partner will be disregarded for purposes of section 706(b).

Explanation of Provisions

I. Treatment of Foreign Partners

Currently, foreign partners are taken into consideration when determining a partnership's taxable year under section 706(b). In some circumstances, this could allow the taxable year of a partnership to be determined for Federal tax purposes by reference to the taxable year of one or more partners who may not be subject to U.S. taxation on income earned through the partnership. For instance, assume that a foreign partner owns a majority interest in a partnership that generates only foreign source income that is not effectively connected with a trade or business conducted within the United States. The minority partners are domestic persons subject to tax in the United States on income earned through the partnership. If the taxable year or years of the domestic partners are different from that of the majority partner, the majority partner's taxable year would determine the partnership's taxable year, which would affect the timing of the domestic partners' inclusion of partnership income. Thus, by conforming the partnership's taxable year to the taxable year of foreign partners, the mechanical application of section 706(b) can create deferral for those partners who are subject to tax in the United States on income earned through the partnership, while having no impact on the majority foreign partners who are not subject to tax in the United States on such income. The IRS and the Treasury do not believe that such a result is consistent with the intent of the statute.

A. Disregard Certain Foreign Partners

The proposed regulations generally require foreign partners who are not subject to U.S. taxation on a net basis on income earned through the partnership to be disregarded for purposes of applying section 706(b). For these purposes a foreign partner will be considered subject to Federal income tax only if the partner is allocated gross income of the partnership that is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States (effectively connected income or ECI). In the case of a foreign partner claiming benefits under a U.S. income tax treaty, a foreign partner will be disregarded unless it is allocated gross income that is attributable to a permanent establishment in the United States.

A foreign partner also may be subject to U.S. Federal income tax on its distributive share of fixed or determinable annual or periodic income (FDAP income) from U.S. sources. In certain circumstances, the timing for imposing United States withholding tax on FDAP income earned through a partnership may be affected by the partnership's taxable year. See, e.g., § 1.1441–5(b)(2)(i) (providing the timing for withholding under section 1441 in the case of a domestic partnership that has received, but not distributed, FDAP income that is includible in the distributive share of a foreign partner). The IRS and Treasury believe that the withholding provisions of section 1441 provide a more appropriate mechanism than section 706 for addressing timing issues for these partners. Additionally, the IRS and Treasury are concerned that the ability of a partnership to earn small amounts of FDAP income, and thereby alter the determination of its taxable year, may permit inappropriate manipulation of the rule under section 706(b) for the domestic partners. Accordingly, under these proposed regulations, the taxable year of a foreign partner would be disregarded for purposes of section 706(b) if that partner is subject to Federal income tax solely due to the presence of U.S. source income earned through the partnership that is not ECI. In addition, it is irrelevant, for purposes of the proposed regulations, whether the foreign partner is subject to tax in the United States with respect to income other than income earned by the partnership.

The rule for foreign partners provided in these proposed regulations generally is consistent with the present rule under § 1.706–3T for the treatment of partners that are exempt from taxation under section 501(a). The taxable years of tax-exempt partners are not considered for purposes of section 706(b) unless those partners are subject to tax on income from the partnership. One difference between the rules for foreign partners and the rules for tax-exempt partners is that foreign partners will be included in determining a partnership's taxable year where the foreign partner is allocated gross income that is effectively connected with a U.S. trade or business, but actually has a net loss from the partnership for the taxable year (i.e., the foreign partners are not actually subject to tax on their allocable portion of the partnership's income). By contrast, a tax-exempt partner is disregarded where its allocable share of the partnership's tax items produces a net loss for the taxable year even though, if the foreign partner were allocated net income for the taxable year, the tax-exempt entity would have been subject to tax on such income. The IRS and Treasury are considering modifying the tax-exempt rule to conform with the proposed rule for foreign partners and request comments in this regard.

Finally, for purposes of these rules, the proposed regulations generally define a foreign partner as a partner that is not a U.S. person (as defined in section 7701(a)(30)), but provide that controlled foreign corporations (CFCs) and foreign personal holding companies (FPHCs) are not treated as foreign partners. These entities are not treated as foreign for purposes of determining a partnership's taxable year under section 706 because the U.S. owners of such entities may be subject to Federal income taxation on a current basis with respect to income earned by the entities.

The IRS and Treasury also considered, but did not include, a similar rule for passive foreign investment companies (PFICs). The proposed regulations do not include a similar rule for PFICs because, unlike the rules for CFCs and FPHCs, which require that a majority of the ownership be concentrated in a small group of U.S. persons, the PFIC rules apply without regard to the level of ownership of the individual, or of all U.S. owners in the aggregate. Additionally, in most instances where a PFIC does have substantial U.S. ownership, it will also be a CFC or a FPHC.

B. Minority Interest Rule

The IRS and Treasury recognize that requiring a partnership taxable year to be determined without regard to certain foreign partners may present difficulties for minority partners in some cases. If the taxable years of certain foreign partners are disregarded for purposes of section 706(b), it is possible that the taxable year of a partnership may be determined solely by reference to the taxable year of one or more small minority domestic partners. This could create significant administrative burdens for minority partners if the partnership maintains its books and records on a taxable year selected by significant foreign partners that is different from the taxable year of the minority partner or partners.

In order to provide relief in this situation, the proposed regulations contain an exception providing that foreign partners will not be disregarded

for purposes of section 706(b) if the partnership's taxable year would be determined by reference to partners that individually hold less than a 10-percent interest, and in the aggregate hold less than a 20-percent interest, in the capital and profits of the partnership. For purposes of this rule, a partner's interest will include interests held directly and interests held by related partners. In determining whether the minority interest rule applies, the proposed regulations take into account the ownership of tax-exempt entities that are disregarded under § 1.706–3T(a).

Where a domestic tax-exempt entity (or entities) owns a relatively small interest in the partnership, but enough to cause the minority interest rule not to apply, the result may be anomalous, given that the tax-exempt entity has no real interest in a particular taxable year and thus has no incentive to convince significant foreign partners to cause the partnership to determine its taxable year by reference to the domestic partners. However, where such a tax-exempt entity (or entities) owns a majority interest in the partnership, the result may be more appropriate because the domestic partners are more likely to have significant bargaining power regarding the taxable year vis-a-vis the foreign partners. An appropriate solution may be to exclude tax-exempt entities from both the numerator and denominator in applying the de minimis rule. The IRS and Treasury request comments regarding how tax-exempt entities should be treated for purposes of the minority interest rule.

C. Transitional Relief

Under current law, a partnership may have adopted a taxable year that creates deferral by reference to the taxable year of a foreign partner not subject to U.S. net income taxation. In such instances, compliance with these regulations could result in a change in the partnership taxable year which would cause a ''bunching'' of more than 12 months of partnership income into a single taxable year of the partners subject to Federal income tax.

For example, consider a partnership that has a June 30 taxable year because of the presence of a 60-percent foreign partner that is not subject to U.S. net income taxation on income earned through the partnership. This taxable year creates six months of deferral for the 40-percent domestic partner, who is on the calendar year. In the year that these proposed regulations become effective, two partnership taxable years (the taxable year concluding on June 30 and the initial short calendar year concluding December 31) would close during the domestic partner's taxable year. Thus, section 706(a) would require the domestic partner to recognize its distributive share of 18 months of partnership income during a single taxable year. While the historic taxable year of the partnership in this example is inconsistent with the intent of section 706(b), the IRS and Treasury recognize that the potential bunching of income caused by changing to an appropriate taxable year might present an undue hardship for some taxpayers.

In order to alleviate such a hardship, the proposed regulations would permit adversely affected taxpayers to apply the four-year spread provisions of § 1.702–3T. This transitional rule will have limited application; it is intended only to provide relief for bunching of income that occurs in the first taxable year beginning on or after the effective date of these proposed regulations.

II. Application of § 1.701–2

The mechanical rules of section 706(b) operate to limit partners' opportunities to defer the recognition of partnership income. Where partners have different taxable years, eliminating or limiting deferral for one partner may result in increasing deferral for another partner. Such deferral is an anticipated result of section 706(b). However, an application of the mechanical rules of section 706(b) and these proposed regulations remains subject to the anti-abuse rule of § 1.701–2.

For example, assume that these proposed regulations would disregard the taxable year of a 76-percent foreign partner and require the partnership (which only has foreign operations, and therefore does not earn ECI) to adopt the taxable year of the 24-percent domestic partner. Conceivably the partners could attempt to avoid this result by forming a tiered structure where the foreign partner would own a 95-percent interest in an upper-tier domestic partnership that would hold, as its only asset, an 80 percent interest in the lower-tier operating partnership (the domestic partner would own the remaining 5 percent of the upper-tier partnership and the remaining 20 percent of the lower-tier partnership). In substance, this is the same arrangement as the single partnership except that the minority interest rule would generally require the upper-tier partnership to adopt the taxable year of the foreign partner (because the domestic partner owns less than a 10-percent interest in the upper-tier partnership). The upper-tier domestic partnership's taxable year would then be considered the majority interest taxable year of the lower-tier partnership under section 706(b)(1)(B)(i). In these circumstances, the Commissioner may determine that in order to achieve a tax result that is consistent with the intent of section 706, § 1.701–2 should apply. In such event, the Commissioner may disregard the upper-tier partnership and treat the assets thereof (in this case, the interest in the lower-tier partnership) as being owned directly by its partners, with the result that the foreign partner would be disregarded in determining the taxable year of the lower-tier partnership under section 706(b) and these proposed regulations.

III. Finalization of Prior Proposed Regulations

The current temporary regulations under section 706 are the product of three separate Treasury decisions. The text of these Treasury decisions, TD 7991 (adopted November 29, 1984), TD 8169 (adopted December 23, 1987), and TD 8205 (adopted May 24, 1988), were also contemporaneously promulgated as proposed regulations, LR–183–84 (published in the **Federal Register** on November 30, 1984), LR–101–86 (published in the **Federal Register** on December 29, 1987), and LR–53–880 (published in the **Federal Register** on May 27, 1988). These proposed regulations have not been withdrawn, and it is likely that they will be finalized in conjunction with the finalization of the regulations proposed by this document. The IRS and Treasury expect that the finalization of these previously proposed regulations will be accompanied by the withdrawal of the existing temporary regulations. Comments previously received in connection with the prior proposed regulations will be considered as well as new or additional comments with respect to such regulations.

IV. Effective Date

These regulations are proposed to apply to partnership taxable years beginning on or after the date final regulations are published in the **Federal Register**. For example, if the final regulations were published on November 1, 2001, a partnership that historically has determined its taxable year by reference to a 75-percent foreign partner with a March 31 taxable year end rather than by reference to a 25-percent domestic partner that uses the calendar year would be required to change to the calendar year as of April 1, 2002 (the partnership year beginning after the date final regulations were published). This would result in a short taxable year from April 1, 2002, to December 31, 2002.

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 also has 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 these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 6, 2001, beginning at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit timely written comments and must submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by May 16, 2001.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Dan Carmody, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 1.706–4 is added to read as follows:

§ 1.706–4 Certain foreign partners disregarded.

(a) *General rule*—(1) *Foreign partners not claiming benefits under a U.S. income tax treaty.* In determining the taxable year (the current taxable year) of a partnership under section 706(b) and the regulations thereunder, a foreign partner shall be disregarded unless such partner is allocated any gross income of the partnership that was effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States during the partnership's taxable year immediately preceding the current taxable year. However, if a foreign partner was not a partner during the partnership's immediately preceding taxable year, such partner will be disregarded for the current taxable year if the partnership reasonably believes that the partner will not be allocated any gross income generated by the partnership during the current taxable year that is effectively connected with the conduct of a trade or business within the United States.

(2) Foreign partners claiming benefits under a U.S. income tax treaty. In the case of a foreign partner claiming benefits under an income tax treaty between the United States and another jurisdiction, a foreign partner will be disregarded under this paragraph (a) unless such partner was allocated any gross income that was attributable to a permanent establishment in the United States during the partnership's taxable year immediately preceding the current taxable year (or, if such partner was not a partner during the immediately preceding taxable year, the partnership reasonably believes that such partner will be allocated such income during the current taxable year).

(b) *Minority interest rule.* If the partners that are not disregarded by paragraph (a) of this section (absent the application of this paragraph (b)) individually hold less than a 10-percent interest, and in the aggregate hold less than a 20-percent interest, in the capital and profits of the partnership, paragraph (a) of this section will not apply. For purposes of determining ownership in the partnership after application of paragraph (a) of this section, the constructive ownership rules of section 318 shall apply, and the attribution rules of section 267(c) also shall apply to the extent they attribute ownership to persons to whom section 318 does not attribute ownership. However, ''10 percent'' shall be substituted for ''50 percent'' in section 318(a)(2)(C) and (3)(C). For purposes of determining if partners hold less than a 20-percent interest in the aggregate, the same interests will not be considered as being owned by more than one partner.

(c) *Definition of foreign partner.* For purposes of this section, a foreign partner is any partner that is not a U.S. person (as defined in section 7701(a)(30)), except that a partner that is a controlled foreign corporation (as defined in section 957(a)) or a foreign personal holding company (as defined in section 552) shall not be treated as a foreign partner.

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example. Partnership B is owned by two partners, F, a foreign corporation that owns a 95-percent interest in the capital and profits of partnership B, and D, a domestic corporation that owns the remaining 5-percent interest in the capital and profits of partnership B. Partnership B is not engaged in the conduct of a trade or business within the United States, and, accordingly, partnership B does not earn any income that is effectively connected with a U.S. trade or business. F uses a March 31 fiscal year, and causes partnership B to maintain its books and records on a March 31 fiscal year as well. D is a calendar year taxpayer. Under paragraph (a) of this section, F would be disregarded and partnership B's taxable year would be determined by reference to D. However, because D owns less than a 10-percent interest in the capital and profits of partnership B, the minority interest rule of paragraph (b) of this section applies, and

partnership B must adopt the March 31 fiscal year.

(e) *Effective date*—(1) *Generally.* The provisions of this section are applicable for partnership taxable years that begin on or after the date final regulations are published in the **Federal Register**.

(2) *Transition rule.* Partners of a partnership that is required to change its taxable year as of the beginning of its first taxable year after the date final regulations are published in the **Federal Register** may apply the provisions of § 1.702–3T if the change in taxable year occurs in the first taxable year following the date final regulations are published in the **Federal Register**.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

[FR Doc. 01–270 Filed 1–16–01; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[Reg–107175–00]

RIN 1545–AY19

Definition of Disqualified Person

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations to narrow the definition of the term disqualified person for section 1031 like-kind exchanges. The regulations are in response to recent changes in the federal banking law, especially the repeal of section 20 of the Glass-Steagall Act of 1933. The regulations will affect the eligibility of certain persons to serve as escrow holders of qualified escrow accounts, trustees of qualified trusts, or as qualified intermediaries. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by April 17, 2001. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for June 5, 2001, at 10 a.m. must be received by May 15, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–107175–00), room 5226, Internal Revenue Service, Post Office Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–107175–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.ustreas.gov /tax_regs /regslist.html.* The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, J. Peter Baumgarten, at (202) 622–4950; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Treena Garrett, at (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) for the definition of disqualified person under section 1.1031(k)–1(k).

An exchange of property, like a sale, usually results in the current recognition of gain or loss. Section 1031(a) provides an exception to the general rule. Under section 1031(a), no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind that is to be held either for productive use in a trade or business or for investment.

Taxpayers may use a qualified escrow account, qualified trust, or qualified intermediary (or any combination of the three) to facilitate a like-kind exchange. A requirement common to qualified escrow accounts, qualified trusts, and qualified intermediaries is that the escrow holder, trustee, or intermediary may not be the taxpayer or a disqualified person.

Section 1.1031(k)-1(k) defines a disqualified person to include a person that is an agent of the taxpayer at the time of the transaction. An agent includes a person that has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within two years of the taxpayer's transfer of relinquished property. However, in determining whether a person is a disqualified person, services provided by such person for the taxpayer with respect to section 1031 exchanges of property and routine financial, title insurance, escrow, or trust services provided to the taxpayer by a financial institution, title insurance company, or escrow company are not taken into account. A person that is related to a disqualified person, determined by using the attribution rules of sections 267(b) and 707(b) but substituting 10 percent for 50 percent, is also considered a disqualified person.

Under section 20 of the Banking Act of 1933 (12 U.S.C. 377) (the Glass-Steagall Act), banks generally were proscribed from affiliation with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. However, last year Congress enacted the Gramm-Leach-Bliley Act, Public Law 106–102 (November 12, 1999), 113 Stat. 1341 (the GLB Act). Section 101 of the GLB Act repeals section 20 of the Glass-Steagall Act. In addition, section 103 of the GLB Act amends section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843) by adding new subsection (k). Subsection (k) specifically authorizes qualifying financial institutions to engage in activities that are financial in nature, such as (1) providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3)); (2) issuing and selling instruments representing interests in pools of assets permissible for a bank to hold directly; and (3) underwriting, dealing in, and making a market in securities.

As a consequence of the GLB Act (and other changes in policy by the Federal Reserve System in recent years), many banks and bank holding companies are, or are in the process of becoming, members of controlled groups that include investment banking and brokerage firms. This, in turn, may cause the banks, bank holding companies, and their subsidiaries to be disqualified persons for purposes of section 1031 by virtue of the related party rule of § 1.1031(k)–1(k)(4).

Treasury and the Service believe that, in general, banks should be permitted to serve as qualified intermediaries, escrow holders, or trustees. Banks, as regulated institutions, have historically acted in this role as neutral or independent holders of funds. These regulations permit banks to continue in this role despite recent legislative and regulatory changes.