

of section 954(d)(3)). This paragraph (e)(6)(v) shall apply regardless of whether a subsequent transfer was part of a plan (or series of related transactions) that includes the controlled foreign corporation's acquisition of the United States property.

(vi) *Examples.* The rules of this paragraph (e)(6) are illustrated by the following examples:

*Example 1. (i) Facts.* USP, a domestic corporation, is the common parent of an affiliated group that joins in the filing of a consolidated return. USP owns 100 percent of the stock of US1 and US2, both domestic corporations and members of the USP consolidated group. US1 owns 100 percent of the stock of CFC, a controlled foreign corporation. US2 issues \$100x of its stock to CFC in exchange for \$10x of CFC stock and \$90x cash. US2's transfer of its stock to CFC is described in section 351. US2 recognizes no gain in the exchange under section 1032(a), and CFC's basis in the US2 stock acquired in the exchange is determined under section 362(a).

(ii) *Analysis.* The US2 stock acquired by CFC in the exchange constitutes United States property under paragraph (e)(6)(ii) of this section because CFC acquires the US2 stock from US2, the issuing corporation. Therefore, because CFC's basis in the US2 stock is determined under section 362(a), then for purposes of section 956, CFC's basis in the US2 stock shall, under paragraph (e)(6)(iii) of this section, be no less than \$90x, the fair market value of the property exchanged by CFC for the US2 stock (the \$10x of CFC stock issued in the exchange does not constitute property for purposes of paragraph (e)(6)(iii) of this section). Pursuant to paragraph (e)(6)(iv) of this section, for purposes of § 1.956-2(d)(1)(i)(a) CFC shall be treated as acquiring its basis of no less than \$90x in the US2 stock at the time of its transfer of property to US2 in exchange for the US2 stock. The result would be the same if, instead of CFC transferring \$90x of cash to US2 in the exchange, CFC assumes a \$90x liability of US2.

*Example 2. (i) Facts.* USP, a domestic corporation owns 100 percent of the stock of USS, a domestic corporation. USP also owns 100 percent of the stock of CFC, a controlled foreign corporation. USP's basis in its USS stock equals the fair market value of the USS stock, or \$100x. USP transfers its USS stock to CFC in exchange for \$100x of CFC stock. USP's transfer of its USS stock to CFC is described in section 351. USP recognizes no gain in the exchange under section 351(a), and CFC's basis in the USS stock acquired in the exchange, determined under section 362(a), equals \$100x.

(ii) *Analysis.* The USS stock acquired by CFC in the exchange does not constitute United States property under paragraph (e)(6)(ii) of this section because CFC acquires the USS stock from USP. Therefore, CFC's basis in the US2 stock, for purposes of section 956, is not determined under this paragraph (e)(6). Instead, CFC's basis in the USS stock is determined under the general rule of section 956(a) and under § 1.956-

1(e)(1)-(4). As determined under section 362(a), CFC's basis in the USS stock is \$100x.

*Example 3. (i) Facts.* USP, a domestic corporation, owns 100 percent of the stock of CFC1, a controlled foreign corporation. CFC1 holds United States property (within the meaning of paragraph (e)(6)(ii) of this section) with a basis of \$30x for purposes of section 956 that was determined under paragraph (e)(6)(iii) of this section. CFC1 owns 100 percent of the stock of CFC2, a controlled foreign corporation. CFC1 transfers the United States property to CFC2 in an exchange described in section 351. CFC2's basis in the United States property is determined under section 362(a).

(ii) *Analysis.* In the section 351 exchange, CFC1 transferred United States property to CFC2 with a basis that was determined under paragraph (e)(6)(iii) of this section. Further, CFC2's basis in the United States property is determined under section 362(a) by reference, in whole or in part, to CFC's basis in such property. Therefore, for purposes of section 956, pursuant to paragraph (e)(6)(v) of this section CFC2's basis in the United States property shall be no less than \$30x. Paragraph (e)(6)(v) of this section would also apply if CFC2 subsequently transfers the United States property to another person related to CFC1 (within the meaning of section 954(d)(3)) if such related person's basis in the United States property is determined by reference, in whole or in part, to CFC2's basis in such property.

(f) *Effective/applicability date.* (1) Paragraph (e)(5) of this section is effective June 14, 1988, with respect to investments made on or after June 14, 1988. Paragraph (e)(6) of this section applies to nonrecognition property acquired in exchanges occurring on or after June 24, 2008.

(2) The applicability of paragraph (e)(6) of this section will expire on June 23, 2011.

**Steven T. Miller,**

*Acting Deputy Commissioner for Services and Enforcement.*

Approved: June 6, 2008.

**Eric Solomon,**

*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. E8-14171 Filed 6-23-08; 8:45 am]

**BILLING CODE 4830-01-P**

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Parts 1 and 602

[TD 9403]

RIN 1545-BH02

#### Guidance Under Section 664 Regarding the Effect of Unrelated Business Taxable Income on Charitable Remainder Trusts

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

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations that provide guidance under Internal Revenue Code (Code) section 664 on the tax effect of unrelated business taxable income (UBTI) on charitable remainder trusts. The regulations reflect the changes made to section 664(c) by section 424(a) and (b) of the Tax Relief and Health Care Act of 2006. The regulations affect charitable remainder trusts that have UBTI in taxable years beginning after December 31, 2006.

**DATES:** *Effective Date:* The regulations are effective on June 24, 2008.

*Applicability Date:* For dates of applicability, see § 1.664-1(c)(3).

**FOR FURTHER INFORMATION CONTACT:** Cynthia Morton at (202) 622-3060 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2101. The collection of information in these final regulations is in § 1.664-1(c)(1). This information is required to enable a charitable remainder trust to report and pay the excise tax due on any UBTI of the trust.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax information are confidential, as required by 26 U.S.C. 6103.

## Background and Explanation of Provisions

This document contains amendments to 26 CFR part 1 under section 664 of the Code. On March 7, 2008, proposed regulations (REG-127391-07) relating to the tax effect of UBTI on charitable remainder trusts were published in the **Federal Register** (73 FR 12313). Although two comments were received in response to the proposed regulations, no request to speak was submitted, so no public hearing was held (see 73 FR 18729). After consideration of the comments, the proposed regulations are adopted by this Treasury decision without substantive change.

For taxable years beginning before January 1, 2007, section 664(c) provided that a charitable remainder trust (whether a charitable remainder annuity trust or a charitable remainder unitrust) would not be exempt from income tax for any year in which the trust had any UBTI (within the meaning of section 512). Instead, such trust was taxed for each such year under subchapter J as though it were a nonexempt, complex trust. The final regulations reflect the changes to section 664(c) made by section 424 of the Tax Relief and Health Care Act of 2006 (Act), Public Law 109-432, 120 Stat. 2922. Section 424(a) of the Act, which applies to taxable years beginning after December 31, 2006, provides that charitable remainder trusts that have UBTI remain exempt from Federal income tax, but imposes a 100-percent excise tax on their UBTI.

The regulations confirm that, for purposes of determining the character of the distribution made to the beneficiary, the charitable remainder trust income that is UBTI is considered income of the trust. Specifically, income of the charitable remainder trust is allocated among the trust income categories in Treasury Regulation § 1.664-1(d)(1) without regard to whether any part of that income constitutes UBTI under section 512. The regulations also confirm that, consistent with § 1.664-1(d)(2), the excise tax imposed upon a charitable remainder trust with UBTI is treated as paid from corpus.

## Summary of Comments

### *Comments Relating to Transitional Relief*

The two commentators requested transitional relief to allow time for charitable remainder trusts with investments producing significant UBTI to restructure these investments. The commentators noted that the Tax Relief and Health Care Act of 2006 revising section 664(c) was signed into law on December 20, 2006, and became

effective for tax years beginning after December 31, 2006. Consequently, charitable remainder trusts had 11 days to make changes in their investments in response to the legislation.

The Treasury Department and the IRS have carefully considered the concerns of the commentators and the request for transitional relief, but have not adopted this comment. The primary objective of adopting the tax on UBTI was to eliminate a source of unfair competition by placing the unrelated business activities of certain exempt organizations on the same tax basis as the nonexempt businesses with which they compete. See § 1.513-1(b). The provision denying the income tax exemption for charitable remainder trusts in years in which the trust has UBTI was enacted because Congress did “not believe that it is appropriate to allow the unrelated business income tax to be avoided by the use of a charitable remainder trust rather than a tax-exempt organization”. See Public Law 91-172, Senate Report 91-552 (H.R. 13270), CB 1969-3, P. 481-2. The sanction imposed under prior law on a charitable remainder trust investing in UBTI-producing asset(s), specifically the loss of tax-exempt status, was generally viewed as particularly onerous. Section 424 of the Act changed the sanction to alleviate its severity, but did not reflect any change in the long-standing policy to sanction and thus to discourage such investment by charitable remainder trusts.

## Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This reporting burden flows directly from the statute implemented by these regulations. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) (RFA) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

## Drafting Information

The principal author of the regulations is Cynthia Morton, Office of the Associate Chief Counsel (Passthroughs and Special Industries).

## List of Subjects

### *26 CFR Part 1*

Income taxes, Reporting and recordkeeping requirements.

### *26 CFR Part 602*

Reporting and recordkeeping requirements.

## Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 1 and 602 are 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 1.664-1 is amended as follows:

■ 1. In paragraph (a)(1)(i), the last sentence is revised and two sentences are added to the end of the paragraph.

■ 2. Paragraph (c) is revised.

■ 3. In paragraph (d)(2), the fourth sentence is revised.

The revisions and addition read as follows:

### **§ 1.664-1 Charitable remainder trusts.**

(a) \* \* \* (1) \* \* \* (i) \* \* \* A trust created after July 31, 1969, which is a charitable remainder trust, is exempt from all of the taxes imposed by subtitle A of the Code for any taxable year of the trust, except for a taxable year beginning before January 1, 2007, in which it has unrelated business taxable income. For taxable years beginning after December 31, 2006, an excise tax, treated as imposed by chapter 42, is imposed on charitable remainder trusts that have unrelated business taxable income. See paragraph (c) of this section.

\* \* \* \* \*

(c) *Excise tax on charitable remainder trusts—(1) In general.* For each taxable year beginning after December 31, 2006, in which a charitable remainder annuity trust or a charitable remainder unitrust has any unrelated business taxable income, an excise tax is imposed on that trust in an amount equal to the amount of such unrelated business taxable income. For this purpose, unrelated business taxable income is as defined in section 512, determined as if part III, subchapter F, chapter 1, subtitle A of the Internal Revenue Code applied to

such trust. Such excise tax is treated as imposed by chapter 42 (other than subchapter E) and is reported and payable in accordance with the appropriate forms and instructions. Such excise tax shall be allocated to corpus and, therefore, is not deductible in determining taxable income distributed to a beneficiary. (See paragraph (d)(2) of this section.) The charitable remainder trust income that is unrelated business taxable income constitutes income of the trust for purposes of determining the character of the distribution made to the beneficiary. Income of the charitable remainder trust is allocated among the charitable remainder trust income categories in paragraph (d)(1) of this section without regard to whether any part of that income constitutes unrelated business taxable income under section 512.

(2) *Examples.* The application of the rules in this paragraph (c) may be illustrated by the following examples:

*Example 1.* For 2007, a charitable remainder annuity trust with a taxable year beginning on January 1, 2007, has \$60,000 of ordinary income, including \$10,000 of gross income from a partnership that constitutes unrelated business taxable income to the trust. The trust has no deductions that are directly connected with that income. For that same year, the trust has administration expenses (deductible in computing taxable income) of \$16,000, resulting in net ordinary income of \$44,000. The amount of unrelated business taxable income is computed by taking gross income from an unrelated trade or business and deducting expenses directly connected with carrying on the trade or business, both computed with modifications under section 512(b). Section 512(b)(12) provides a specific deduction of \$1,000 in computing the amount of unrelated business taxable income. Under the facts presented in this example, there are no other modifications under section 512(b). The trust, therefore, has unrelated business taxable income of \$9,000 (\$10,000 minus the \$1,000 deduction under section 512(b)(12)). Undistributed ordinary income from prior years is \$12,000 and undistributed capital gains from prior years are \$50,000. Under the terms of the trust agreement, the trust is required to pay an annuity of \$100,000 for year 2007 to the noncharitable beneficiary. Because the trust has unrelated business taxable income of \$9,000, the excise tax imposed under section 664(c) is equal to the amount of such unrelated business taxable income, \$9,000. The character of the \$100,000 distribution to the noncharitable beneficiary is as follows: \$56,000 of ordinary income (\$44,000 from current year plus \$12,000 from prior years), and \$44,000 of capital gains. The \$9,000 excise tax is allocated to corpus, and does not reduce the amount in any of the categories of income under paragraph (d)(1) of this section. At the beginning of year 2008, the amount of undistributed capital gains is \$6,000, and there is no undistributed ordinary income.

*Example 2.* During 2007, a charitable remainder annuity trust with a taxable year beginning on January 1, 2007, sells real estate generating gain of \$40,000. Because the trust had obtained a loan to finance part of the purchase price of the asset, some of the income from the sale is treated as debt-financed income under section 514 and thus constitutes unrelated business taxable income under section 512. The unrelated debt-financed income computed under section 514 is \$30,000. Assuming the trust receives no other income in 2007, the trust will have unrelated business taxable income under section 512 of \$29,000 (\$30,000 minus the \$1,000 deduction under section 512(b)(12)). Except for section 512(b)(12), no other exceptions or modifications under sections 512–514 apply when calculating unrelated business taxable income based on the facts presented in this example. Because the trust has unrelated business taxable income of \$29,000, the excise tax imposed under section 664(c) is equal to the amount of such unrelated business taxable income, \$29,000. The \$29,000 excise tax is allocated to corpus, and does not reduce the amount in any of the categories of income under paragraph (d)(1) of this section. Regardless of how the trust's income might be treated under sections 511–514, the entire \$40,000 is capital gain for purposes of section 664 and is allocated accordingly to and within the second of the categories of income under paragraph (d)(1) of this section.

(3) *Effective/applicability date.* This paragraph (c) is applicable for taxable years beginning after December 31, 2006. The rules that apply with respect to taxable years beginning before January 1, 2007, are contained in § 1.664–1(c) as in effect prior to June 24, 2008. (See 26 CFR part 1, § 1.664–1(c)(1) revised as of April 1, 2007.)

(d) \* \* \*

(2) \* \* \* All taxes imposed by chapter 42 of the Code (including without limitation taxes treated under section 664(c)(2) as imposed by chapter 42) and, for taxable years beginning prior to January 1, 2007, all taxes imposed by subtitle A of the Code for which the trust is liable because it has unrelated business taxable income, shall be allocated to corpus. \* \* \*

\* \* \* \* \*

## PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 3.** The authority citation for part 602 continues to read as follows:

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

■ **Par. 4.** In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table as follows:

### § 602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

CFR part of section where identified and described	Current OMB control No.
* * * * *	*
1.664–1(c) .....	1545–2101
* * * * *	*

Linda E. Stiff,

*Deputy Commissioner for Services and Enforcement.*

Approved: June 18, 2008.

Eric Solomon,

*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. 08–1380 Filed 6–19–08; 1:29 pm]

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## DEPARTMENT OF DEFENSE

### Department of the Navy

#### 32 CFR Part 706

#### Certifications and Exemptions Under the International Regulations for Preventing Collisions at Sea, 1972

**AGENCY:** Department of the Navy, DoD.

**ACTION:** Final rule.

**SUMMARY:** The Department of the Navy is amending its certifications and exemptions under the International Regulations for Preventing Collisions at Sea, 1972 (72 COLREGS), to reflect that the Deputy Assistant Judge Advocate General (Admiralty and Maritime Law) has determined that USS STOCKDALE (DDG 106) is a vessel of the Navy which, due to its special construction and purpose, cannot fully comply with certain provisions of the 72 COLREGS without interfering with its special function as a naval ship. The intended effect of this rule is to warn mariners in waters where 72 COLREGS apply.

**DATES:** This rule is effective June 24, 2008 and is applicable beginning 13 June 2008.

**FOR FURTHER INFORMATION CONTACT:** Commander M. Robb Hyde, JAGC, U.S. Navy, Deputy Assistant Judge Advocate General (Admiralty and Maritime Law), Office of the Judge Advocate General, Department of the Navy, 1322 Patterson Ave., SE., Suite 3000, Washington Navy Yard, DC 20374–5066, telephone: 202–685–5040.

**SUPPLEMENTARY INFORMATION:** Pursuant to the authority granted in 33 U.S.C. 1605, the Department of the Navy