

Dated: May 2, 2011.

Rayne Pegg,

Administrator, Agricultural Marketing Service.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9525]

RIN 1545-BG98

Modifications to Treatment of Aircraft and Vessel Leasing Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations addressing the treatment of certain income and assets related to the leasing of aircraft or vessels in foreign commerce. The regulations reflect statutory changes made by the American Jobs Creation Act of 2004. In general, the regulations will affect United States shareholders of controlled foreign corporations that derive income from the leasing of aircraft or vessels in foreign commerce and U.S. persons that transfer property subject to these leases to a foreign corporation.

DATES: *Effective Date:* These regulations are effective on May 6, 2011.

Applicability Dates: For dates of applicability, see §§ 1.367(a)-2(e)(2), 1.367(a)-4(i), 1.367(a)-5(f)(3)(ii), 1.954-2(i) and 1.956-2(e).

FOR FURTHER INFORMATION CONTACT: Concerning the final regulations under section 367, Ronald M. Gootzeit at (202) 622-3860; concerning the final regulations under section 954 or 956, Kristine A. Crabtree at (202) 622-3840; (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

In General

This document contains amendments to 26 CFR Part 1 under sections 367, 954 and 956 of the Internal Revenue Code (Code). Final and temporary regulations (TD 9406, 73 FR 38113) (the temporary regulations) and a cross-reference notice of proposed rulemaking (REG-138355-07, 73 FR 38162) were published in the **Federal Register** on July 3, 2008 (the proposed regulations). On July 29, 2008, corrections to the final regulations (73 FR 43863) were published in the

Federal Register. No public hearing was requested or held with respect to the proposed regulations. After consideration of the comments received, the proposed regulations are adopted, as amended by this Treasury decision.

Explanation of Provisions

Section 415(a) of the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1418) (Jobs Act), repealed section 954(a)(4) and (f), the foreign base company shipping income provisions of subpart F. As a result of the repeal of these provisions, rents derived from leasing an aircraft or vessel in foreign commerce are included in subpart F income only if the rents are described in another category of subpart F income, such as foreign personal holding company income (FPHCI) as defined in section 954(c). Rents are generally included in FPHCI under section 954(c)(1)(A), subject to certain exceptions. One such exception is for rents received from unrelated persons and derived in the active conduct of a trade or business. See section 954(c)(2)(A).

For this purpose, rents derived by a controlled foreign corporation (CFC) are considered derived in the active conduct of a trade or business in certain circumstances, including circumstances whereby the rents are derived as a result of the performance of marketing functions by the lessor CFC with respect to the leased property (the marketing exception). § 1.954-2(c)(1)(iv). Specifically, a lessor satisfies the marketing exception if the lessor, through its own officers or staff of employees located in a foreign country, maintains and operates an organization in the foreign country that is regularly engaged in the business of marketing, or of marketing and servicing, the leased property and that is substantial in relation to the amount of rents derived from leasing the property. For this purpose, whether an organization in a foreign country is substantial in relation to the amount of rents is determined based on all facts and circumstances; however, such an organization will be considered substantial if active leasing expenses equal or exceed 25 percent of the adjusted leasing profit (as defined in § 1.954-2(c)(2)(iv)). § 1.954-2T(c)(2)(ii).

The Jobs Act amended section 954(c)(2)(A) to expand the marketing exception with respect to rents derived from leasing an aircraft or vessel in foreign commerce. In particular, section 954(c)(2)(A) now provides that “rents derived from leasing an aircraft or vessel in foreign commerce shall not fail to be treated as derived in the active conduct of a trade or business if, as determined

under regulations prescribed by the Secretary, the active leasing expenses are not less than 10 percent of the profit on the lease.” In addition, the legislative history to this provision states that the Secretary of the Treasury will make “conforming changes to existing regulations, including guidance that aircraft or vessel leasing activity that satisfies the requirements of section 954(c)(2)(A) shall also satisfy the requirements for avoiding income inclusion under section 956 and section 367(a).” H.R. Conf. Rep. No. 755, 108th Cong., 2d Sess. 402 (2004).

On July 3, 2008, the Treasury Department and the IRS published the proposed regulations providing guidance with respect to the treatment of certain income and assets related to the leasing of aircraft or vessels in foreign commerce under sections 367, 954, and 956 of the Code in light of the Jobs Act changes. These final regulations adopt the proposed regulations with the modifications described herein.

Section 954 Regulations

Under current regulations, to satisfy the marketing exception, the lessor must, among other things, maintain an organization that is regularly engaged in the business of marketing, or of marketing and servicing, the leased property and that is “substantial in relation to the rents derived.” § 1.954-2(c)(1)(iv). The proposed regulations added a new marketing safe harbor for purposes of determining whether an organization is substantial in relation to rents derived from leasing aircraft or vessels (including component parts, such as engines, that are leased separately from an aircraft or vessel) in foreign commerce. This safe harbor provides that an organization will be considered substantial for purposes of § 1.954-2(c)(1)(iv) if active leasing expenses equal or exceed 10 percent of the adjusted leasing profit. For this purpose, the rules in the current regulations for computing active leasing expense and adjusted leasing profit continue to apply. The proposed regulations also included a definition of when an aircraft or vessel is leased in foreign commerce, including defining when property is used predominantly outside the United States, that is consistent with the legislative history to the Jobs Act. See H.R. Rep. No. 108-548, pt. 1, at 210 (2004); H.R. Conf. Rep. No. 108-755, at 402 (2004). Finally, the proposed regulations also clarified that rents derived from certain finance leases and acquired leases are eligible for the active rents exclusion.

One commentator expressed concern that § 1.954–2T(c)(2)(vii), which addresses finance leases, could be interpreted to limit the application of the marketing exception solely to finance leases. In response to this comment, the final regulations clarify that the marketing exception can apply to both operating leases and finance leases.

The same commentator also suggested that, for purposes of applying § 1.954–2T(c)(2)(vi), the regulations should clarify that “remarketing functions” include remarketing for purposes of selling the leased property. The final regulations adopt this change.

In addition to these changes, the final regulations clarify that an aircraft or vessel is considered to be leased in foreign commerce if it is used in foreign commerce, and is used predominantly outside the United States. Finally, the language of § 1.954–2T(c)(3) *Example 6* has been modified to make it consistent with the other examples in § 1.954–2(c)(3).

Section 956 Regulations

Section 956(c)(1)(A) provides that the term *United States property* (“U.S. property”) generally includes tangible property located in the United States. Section 956(c)(2) provides exceptions to the general definition of U.S. property, including any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States. See section 956(c)(2)(D). Prior to issuance of the temporary regulations, § 1.956–2(b)(1)(vi) provided that, as a general rule, such transportation property will be considered to be used predominantly outside the United States if 70 percent or more of the miles traversed (during the taxable year at the close of which a determination is made under section 956(a)(2)) in the use of such property are traversed outside the United States or if such property is located outside the United States 70 percent of the time during such taxable year.

In Notice 2006–48 (2006–1 CB 922) the IRS and Treasury Department announced that regulations would be issued providing that an aircraft or vessel used in the transportation of persons or property in foreign commerce is excluded from U.S. property under § 1.956–2(b)(1)(vi) if rents derived from leasing such aircraft or vessel are excluded from FPHCI under section 954(c)(2)(A) and such property is considered to be used predominantly outside the United States under § 1.954–2(b)(1)(vi), determined by

substituting “more than 50 percent” for the phrases “70 percent or more” and “70 percent.” The proposed regulations amended § 1.956–2(b)(1)(vi) to provide that an aircraft or vessel is excluded from U.S. property if rents derived from leasing such aircraft or vessel are excluded from FPHCI under section 954(c)(2)(A) but inadvertently omitted the language from Notice 2006–48 concerning its use in the transportation of persons or property in foreign commerce and its predominant use outside the United States. Consistent with section 956(c)(2)(D), the legislative history of section 954(c)(2)(A), and Notice 2006–48, the final regulations modify the proposed regulations to clarify that an aircraft or vessel is excepted from the definition of U.S. property under section 956(c)(2)(D) only if the aircraft or vessel is leased in foreign commerce as that term is defined in § 1.954–2(c)(2)(v), and the rents from the aircraft or vessel qualify for the exception to FPHCI under section 954(c)(2)(A). See § 601.601(d)(2).

No comments were received and no changes other than the change described herein have been made to the section 956 provisions of the proposed regulations.

Section 367 Regulations

No written comments were received and no changes have been made to the section 367 provisions of the proposed regulations.

Request for Comments

The Treasury Department and IRS continue to study and request comments on how to determine whether an aircraft or vessel is used predominantly outside the United States during a particular month for purposes of calculating depreciation recapture under section 367. Until further guidance is issued, taxpayers may continue to use any reasonable method to make this determination.

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, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. Ch. 6) does not apply. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business

Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Ronald M. Gootzeit and Kristine A. Crabtree, Office of Associate Chief Counsel (International). 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.

Adoption of 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 continues to read in part as follows:

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

■ **Par. 2.** Section 1.367(a)–2 is added to read as follows:

§ 1.367(a)–2 Exception for transfers of property for use in the active conduct of a trade or business.

(a) through (d) [Reserved]. For further guidance, see § 1.367(a)–2T(a) through (d).

(e) *Special rules for certain transfers occurring on or after May 2, 2006—*
(1) *General rule.* Whether a trade or business that produces rents or royalties is actively conducted shall be determined under the principles of section 954(c)(2)(A) and the regulations thereunder (but without regard to whether the rents or royalties are received from an unrelated party). See § 1.954–2(c) and (d).

(2) *Effective/applicability date.* The rules of this paragraph (e) apply to transfers occurring on or after May 2, 2006. However, if the transferor makes the election to apply the provisions of § 1.367(a)–4(c)(3) for transfers occurring on or after October 22, 2004, then paragraph (e)(1) of this section will also apply to the transfers occurring on or after October 22, 2004.

■ **Par. 3.** Section 1.367(a)–2T is amended by removing and reserving paragraph (e) to read as follows:

§ 1.367(a)–2T Exception for transfers of property for the use in the active conduct of a trade or business (temporary).

* * * * *

(e) [Reserved]. For further guidance see § 1.367(a)–2(e).

■ **Par. 4.** Section 1.367(a)–4 is added to read as follows:

§ 1.367(a)–4 Special rules applicable to specified transfers of property.

(a) through (c)(2) [Reserved]. For further guidance, see § 1.367(a)–4T(a) through (c)(2).

(3) *Aircraft and vessels leased in foreign commerce.* For purposes of satisfying § 1.367–4T(c)(1), aircraft or vessels, including component parts such as engines leased separately from aircraft or vessels, transferred to a foreign corporation and leased to other persons by the foreign corporation shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The employees of the foreign corporation perform substantial managerial and operational activities of leasing aircraft or vessels outside the United States; and

(ii) The leased tangible personal property is predominantly used outside the United States, as determined under § 1.954–2(c)(2)(v).

(d) through (h) [Reserved]. For further guidance, see § 1.367–4T(d) through (h).

(i) *Effective/applicability date.* The rules of paragraph (c)(3) of this section apply for transfers of property occurring on or after May 2, 2006. Transferors may elect to apply these provisions to transfers occurring on or after October 22, 2004, by citing the provisions of paragraph (c)(3) of this section in the documentation for such transfers required by § 1.6038B–1T(c)(4)(i) and (iv).

■ **Par. 5.** Section 1.367(a)–4T is amended by removing and reserving paragraphs (c)(3) and (i) to read as follows:

§ 1.367(a)–4T Special rules applicable to specified transfers of property (temporary).

* * * * *

(c) * * *

(3) [Reserved]. For further guidance see § 1.367(a)–4(c)(3).

* * * * *

(i) [Reserved]. For further guidance see § 1.367(a)–4(i).

■ **Par. 6.** Section § 1.367(a)–5 is added to read as follows:

§ 1.367(a)–5 Property subject to section 367(a)(1) regardless of use in a trade or business.

(a) through (f)(2) [Reserved]. For further guidance, see § 1.367(a)–5T(a) through (f)(2).

(3)(i) With respect to vessels and aircraft, including their component parts, that will be leased by the transferee to third persons, the transferee satisfies the conditions set forth in § 1.367(a)–4(c)(3).

(ii) *Effective/applicability date.* The rules of this paragraph (f)(3) apply to

transfers of property occurring on or after May 2, 2006. If the transferor makes the election to apply the provisions of § 1.367(a)–4(c)(3) to transfers occurring on or after October 22, 2004, then paragraph (f)(3)(i) of this section will also apply to transfers affected by that election.

■ **Par. 7.** Section § 1.367(a)–5T is amended by removing and reserving paragraph (f)(3) to read as follows:

§ 1.367(a)–5T Property subject to section 367(a)(1) regardless of use in trade or business (temporary).

* * * * *

(f) * * *

(3) [Reserved]. For further guidance see § 1.367(a)–5(f)(3).

■ **Par. 8.** Section 1.954–2 is amended by revising paragraphs (c)(2)(ii), (c)(2)(v), (c)(2)(vi), (c)(2)(vii), and (c)(3) *Example 6* and paragraph (i) to read as follows:

§ 1.954–2 Foreign personal holding company income.

* * * * *

(c) * * *

(2) * * *

(ii) *Substantiality of foreign organization.* For purposes of paragraph (c)(1)(iv) of this section, whether an organization in a foreign country is substantial in relation to the amount of rents is determined based on all facts and circumstances. However, such an organization will be considered substantial in relation to the amount of rents if active leasing expenses, as defined in paragraph (c)(2)(iii) of this section, equal or exceed 25 percent of the adjusted leasing profit, as defined in paragraph (c)(2)(iv) of this section. In addition, for purposes of aircraft or vessels leased in foreign commerce, an organization will be considered substantial if active leasing expenses, as defined in paragraph (c)(2)(iii) of this section, equal or exceed 10 percent of the adjusted leasing profit, as defined in paragraph (c)(2)(iv) of this section. For purposes of paragraphs (c)(1)(iv) and (c)(2) of this section and § 1.956–2(b)(1)(vi), the term *aircraft or vessels* includes component parts, such as engines that are leased separately from an aircraft or vessel.

* * * * *

(v) *Leased in foreign commerce.* For purposes of paragraphs (c)(1)(iv) and (c)(2)(ii) of this section, an aircraft or vessel is considered to be leased in foreign commerce if the aircraft or vessel is used in foreign commerce and is used predominantly outside the United States. An aircraft or vessel is considered to be used in foreign commerce if it is used for the transportation of property or passengers

between a port (or airport) in the United States and a port (or airport) in a foreign country or between foreign ports (or airports). An aircraft or vessel will be considered to be used predominantly outside the United States if more than 50 percent of the miles traversed during the taxable year in the use of the aircraft or vessel are traversed outside the United States or if the aircraft or vessel is located outside the United States more than 50 percent of the time during the taxable year.

(vi) *Leases acquired by the CFC lessor.*

Except as provided in this paragraph (c)(2)(vi), the exception in paragraph (c)(1)(iv) of this section will also apply to rents from leases acquired from any person, if following the acquisition the lessor performs active and substantial management, operational, and remarketing (including remarketing for purposes of re-leasing or selling the property) functions with respect to the leased property. However, if any person is claiming a benefit with respect to an acquired lease pursuant to section 921 or 114 of the Internal Revenue Code or section 101(d) of the American Jobs Creation Act of 2004, (Pub. L. 108–357 (118 Stat. 1418) (2004)), the rents from such lease, notwithstanding paragraphs (b)(6) and (c) of this section, are ineligible for the exception in section 954(c)(2)(A).

(vii) *Marketing of leases.* Paragraph (c)(1)(iv) of this section can apply whether a lessor is engaged in the marketing of leases as a form of financing or is engaged in marketing the property as such, and regardless of whether the lease is classified as a finance lease or an operating lease for financial accounting purposes, so long as such lease is treated as a lease for Federal income tax purposes.

(3) * * *

Example 6. The facts are the same as in *Example 2*, except that controlled foreign corporation D purchases aircraft which it leases to others. If Corporation D incurs active leasing expenses, as defined in paragraph (c)(2)(iii) of this section, equal to or in excess of 10 percent of its adjusted leasing profit, as defined in paragraph (c)(2)(iv) of this section, the organization maintained and operated by Corporation D in country X is substantial in relation to the amount of rents Corporation D receives from leasing the aircraft. Therefore, under paragraph (c)(1)(iv) of this section, such rents are derived in the active conduct of a trade or business for purposes of section 954(c)(2)(A). If a particular aircraft subject to lease was not leased by the lessee corporation in foreign commerce, for example, because 50 percent or less of the miles during the taxable year were traversed outside the United States and the aircraft was located in the United States for 50 percent or more of the taxable year, Corporation D is not prevented from

otherwise showing that it actively carries on a trade or business with regard to the rents derived from that aircraft under paragraph (c)(2)(ii) of this section, based on its facts and circumstances or a showing that active leasing expenses equal or exceed 25 percent of the adjusted leasing profit.

* * * * *

(i) *Effective/applicability date.* The last two sentences of paragraph (c)(2)(ii), and paragraphs (c)(2)(v) through (vii) and (c)(3) *Example 6* of this section apply to taxable years of controlled foreign corporations beginning on or after May 2, 2006, and for taxable years of United States shareholders with or within which such taxable years of the controlled foreign corporations end. Taxpayers may elect to apply the last two sentences of paragraph (c)(2)(ii) and paragraphs (c)(2)(v) through (vii) to taxable years of controlled foreign corporations beginning after December 31, 2004, and for taxable years of United States shareholders with or within which such taxable years of the controlled foreign corporations end. If an election is made to apply § 1.956-2(b)(1)(vi) to taxable years beginning after December 31, 2004, then the election must also be made for paragraphs (c)(2)(ii) and (c)(2)(v) through (vii) of this section.

§ 1.954-2T [Removed].

■ **Par. 9.** Section 1.954-2T is removed.

■ **Par. 10.** Section 1.956-2 is amended by revising paragraphs (b)(1)(vi) and (e) to read as follows:

§ 1.956-2 Definition of United States property.

* * * * *

(b)* * *

(1)* * *

(vi) Any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States. Whether transportation property described in this paragraph (b)(1)(vi) is used in foreign commerce and predominantly outside the United States is to be determined from all the facts and circumstances of each case. As a general rule, such transportation property will be considered to be used predominantly outside the United States if 70 percent or more of the miles traversed (during the taxable year at the close of which a determination is made under section 956(a)(2)) in the use of such property are traversed outside the United States or if such property is located outside the United States 70 percent of the time during such taxable year. Notwithstanding the above, an aircraft

or vessel, including component parts, is excluded from United States property if the aircraft or vessel is leased in foreign commerce (as the term is defined in § 1.954-2(c)(2)(v)) and rents derived from leasing such aircraft or vessel are excluded from foreign personal holding company income under section 954(c)(2)(A).

* * * * *

(e) *Effective/applicability date.* The last sentence of paragraph (b)(1)(vi) of this section applies to taxable years of controlled foreign corporations beginning on or after May 2, 2006, and for taxable years of United States shareholders with or within which such taxable years of the controlled foreign corporations end. Taxpayers may elect to apply the rule of the last sentence of paragraph (b)(1)(vi) of this section to taxable years of controlled foreign corporations beginning after December 31, 2004, and for taxable years of United States shareholders with or within which such taxable years of the controlled foreign corporations end. If an election is made to apply the last two sentences of § 1.954-2(c)(2)(ii) and § 1.954-2(c)(2)(v) through (vii) to taxable years of a controlled foreign corporation beginning after December 31, 2004, then the election must also be made for the last sentence of paragraph (b)(1)(vi) of this section.

■ **Par. 11.** Section 1.956-2T is amended by removing and reserving paragraphs (b)(1)(vi) and (e) to read as follows:

§ 1.956-2T Definition of United States property (temporary).

* * * * *

(b)* * *

(1)* * *

(vi) [Reserved]. For further guidance see § 1.956-2(b)(1)(vi).

* * * * *

(e) [Reserved]. For further guidance see § 1.956-2(e).

Steven T. Miller,

Deputy Commissioner for Services and Enforcement.

Approved: March 30, 2011.

Michael Mundaca,

Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 117

[Docket No. USCG-2011-0317]

Drawbridge Operation Regulation; Sacramento River, Sacramento, CA

AGENCY: Coast Guard, DHS.

ACTION: Notice of temporary deviation from regulations.

SUMMARY: The Commander, Eleventh Coast Guard District, has issued a temporary deviation from the regulation governing the operation of the Tower Drawbridge across Sacramento River, mile 59.0, at Sacramento, CA. The deviation is necessary to allow the community to participate in the Hope Foundation walk event. This deviation allows the bridge to remain in the closed-to-navigation position during the event.

DATES: This deviation is effective from 8 a.m. to 11 a.m. on May 29, 2011.

ADDRESSES: Documents mentioned in this preamble as being available in the docket are part of the docket USCG-2011-0317 and are available online by going to <http://www.regulations.gov>, inserting USCG-2011-0317 in the "Keyword" box and then clicking "Search". They are also available for inspection or copying at the Docket Management Facility (M-30), U.S. Department of Transportation, West Building Ground Floor, Room W12-140, 1200 New Jersey Avenue, SE., Washington, DC 20590, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: If you have questions on this rule, call or e-mail David H. Sulouff, Chief, Bridge Section, Eleventh Coast Guard District; telephone 510-437-3516, e-mail David.H.Sulouff@uscg.mil. If you have questions on viewing the docket, call Renee V. Wright, Program Manager, Docket Operations, telephone 202-366-9826.

SUPPLEMENTARY INFORMATION: The California Department of Transportation has requested a temporary change to the operation of the Tower Drawbridge, mile 59.0, over Sacramento River, at Sacramento, CA. The drawbridge navigation span provides a vertical clearance of 30 feet above Mean High Water in the closed-to-navigation position. The draw opens on signal from May 1 through October 31 from 6 a.m. to 10 p.m. and from November 1 through April 30 from 9 a.m. to 5 p.m.