and informational impacts of this action on small businesses.

A small business guide on complying with fruit, vegetable, and specialty crop marketing agreements and orders may be viewed at: *http://www.ams.usda.gov/fv/moab.html.* Any questions about the compliance guide should be sent to Jay Guerber at the previously mentioned address in the **FOR FURTHER INFORMATION CONTACT** section.

This rule invites comments on removal of Dancy tangerines and Robinson tangerines from the rules and regulations concerning covered varieties of Florida citrus. Any comments received will be considered prior to finalization of this rule.

After consideration of all relevant material presented, including the committee's recommendation, and other information, it is found that this interim final rule, as hereinafter set forth, will tend to effectuate the declared policy of the Act.

Pursuant to 5 U.S.C. 553, it is also found and determined upon good cause that it is impracticable, unnecessary, and contrary to the public interest to give preliminary notice prior to putting this rule into effect and good cause exists for not postponing the effective date of this rule until 30 days after publication in the **Federal Register**. This rule relaxes handling requirements for two varieties of tangerines and, therefore, should be in place when the handlers begin shipments of these early tangerine varieties, beginning October 1, 2002. This issue has been widely discussed at various industry and association meetings, and the committee has kept the industry well informed. Interested persons have had time to determine and express their positions. Further, handlers are aware of this rule, which was recommended at a public meeting. Also, a 60-day comment period is provided in this rule.

List of Subjects in 7 CFR Part 905

Grapefruit, Marketing agreements, Oranges, Reporting and recordkeeping requirements, Tangelos, Tangerines.

For the reasons set forth in the preamble, 7 CFR Part 905 is amended as follows:

PART 905—ORANGES, GRAPEFRUIT, TANGERINES, AND TANGELOS GROWN IN FLORIDA

1. The authority citation for 7 CFR Part 905 continues to read as follows:

Authority: 7 U.S.C. 601–674.

§ 905.152 [Removed]

2. Section 905.152 is removed.

§ 905.306 [Amended]

3. In § 905.306, Table I and Table II are amended by removing the entries for ''Dancy tangerines'' and ''Robinson tangerines.''

Dated: July 17, 2002.

A.J. Yates,

Administrator, Agricultural Marketing Service.

[FR Doc. 02–18571 Filed 7–22–02; 8:45 am]

BILLING CODE 3410–02–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9009]

RIN 1545–AY66

Taxable Years of Partner and Partnership; Foreign Partners

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations on the taxable year of a partnership with foreign partners and tax-exempt partners. The final regulations provide that in certain circumstances the taxable year of a partnership will be determined without regard to the taxable year of certain foreign partners and certain tax-exempt partners.

DATES: *Effective Date:* These regulations are effective on July 23, 2002.

Applicability Date: For dates of applicability of these regulations, see §§ 1.706–1(b)(5)(iii), (b)(6)(v), and (b)(11)(ii).

FOR FURTHER INFORMATION CONTACT: Dan Carmody, (202) 622–3080 (not a toll-free number). For specific information regarding international issues, contact Ronald M. Gootzeit, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Introduction

This document finalizes portions of § 1.706–1(b) of the Income Tax Regulations (26 CFR part 1) relating to the determination of the taxable year of a partnership with tax-exempt partners and foreign partners. This document also withdraws § 1.706–3T (26 CFR part 1).

Background

On May 24, 1988, Treasury and the Internal Revenue Service (IRS) issued temporary regulations (§ 1.706–3T, promulgated as part of TD 8205 (53 FR 19688)) with a contemporaneous notice of proposed rulemaking (LR–53–88 (53 FR 19715)) relating to the determination of the taxable year of a partnership with tax-exempt partners (the 1988 Proposed Regulations). On January 17, 2001, Treasury and the IRS published in the **Federal Register** a notice of proposed rulemaking [REG–104876–00 (66 FR 3920)] to provide guidance relating to the determination of the taxable year of a partnership with foreign partners (the 2001 Proposed Regulations). In that notice of proposed rulemaking, Treasury and the IRS also indicated that the 1988 Proposed Regulations would be finalized. A public hearing was held on June 6, 2001. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Revisions and Summary of Comments

I. In General

Section 706 provides rules relating to the taxable years of a partnership and its partners. Under section 706(a), in computing the taxable income of a partner for a taxable year, the partner must include 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)(1)(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 1.706–1(b)(2) of the Income Tax Regulations provides that, if neither section 706(b)(1)(B)(i) nor (ii) apply, the partnership's taxable year will be the taxable year that results in the least aggregate deferral of partnership income.

As part of a larger guidance project on accounting periods, the regulations under section 706 were restructured on May 17, 2002 [TD 8996 (67 FR 35009)]. To conform with the restructuring, the regulations finalized by this document will be finalized as amendments to § 1.706–1 even though they were proposed under §§ 1.706–3 and 1.706–4. A small portion of the proposed regulation under § 1.706–3 dealing with the effect of partner elections under

section 444 has been finalized as § 1.706–1(b)(11).

II. Treatment of Tax-Exempt Partners

The 1988 Proposed Regulations provide that, in determining the taxable year (the current year) of a partnership under section 706(b) and the regulations thereunder, a partner that is tax-exempt under section 501(a) is disregarded if such partner was not subject to tax, under chapter 1 of the Internal Revenue Code (Code), on any income attributable to its investment in the partnership during the partnership's taxable year immediately preceding the current year. This Treasury decision finalizes the 1988 Proposed Regulations without substantive change and withdraws the temporary regulations.

III. Treatment of Foreign Partners

A. General Rule

The 2001 Proposed Regulations generally provide that a foreign partner that is not subject to U.S. taxation on a net basis on income earned through the partnership is disregarded for purposes of section 706(b). For these purposes, a foreign partner will be considered subject to U.S. taxation on a net basis 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, such partner is disregarded unless it is allocated any gross income that is attributable to a permanent establishment in the United States.

The final regulations follow the same approach as the proposed regulations, but the general rule has been clarified to provide that a foreign partner is disregarded unless such partner is allocated any gross income that is ECI, and the taxation of the income is not otherwise precluded under any U.S. income tax treaty. Gross income for these purposes does not include income that is excluded under another Code provision (e.g., the exclusion from gross income under section 883 for certain transportation income). Further, as the preamble to the proposed regulations [REG–104876–00 (66 FR 3920, 3922)] states, the Commissioner may challenge an arrangement that, while conforming to these rules, is undertaken with a principal purpose of achieving a tax result that is inconsistent with the intent of section 706. § 1.701–2.

A commentator questioned the statutory authority for regulations that disregard the interest in a partnership held by certain foreign partners in determining a partnership's taxable year under section 706(b). Treasury and the IRS believe that they have the authority to adopt these final regulations in order to resolve ambiguity in the statutory provisions in a manner that is consistent with the objectives of section 706(b) to eliminate or reduce the amount of deferral available on income earned through a partnership.

B. Application of the Minority Interest Rule

Treasury and the IRS 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. For this reason, the proposed regulations include a ''minority interest rule'' which provides that the taxable years of foreign partners are not disregarded for purposes of section 706(b) if no single partner (other than a disregarded foreign partner) holds a 10-percent or greater interest in the capital or profits of the partnership, and if, in the aggregate, the partners that are not disregarded foreign partners do not hold a 20-percent or greater interest in the capital or profits of the partnership.

The 2001 Proposed Regulations provide that, for purposes of determining a partner's ownership in the partnership, the constructive ownership rules of section 318 apply (substituting ''10 percent'' for ''50 percent'' in section 318(a)(2)(C) and (3)(C)) and the attribution rules of section 267(c) also apply to the extent that those rules attribute ownership to persons to whom section 318 does not attribute ownership. These regulations replace this attribution rule with an attribution rule based on the principles of sections 267(b) and 707(b). Attribution under sections 267(b) and 707(b) is more commonly applied in the partnership context than is attribution under section 318, which is generally used to determine constructive ownership of stock.

Commentators expressed concern that the 10- and 20-percent thresholds were too low. They explained that U.S. minority partners would have difficulty reporting partnership income timely under these rules, because a U.S. minority partner typically lacks the practical or legal ability to cause a foreign partnership to close its books and conduct a mid-year accounting. Treasury and the IRS believe that partners can generally negotiate with the partnership to obtain the information needed to comply with their reporting obligations under these regulations. Recognizing, though, that partners in existing partnerships may not be in a position to renegotiate for partnership information, Treasury and the IRS have made these regulations applicable on a mandatory basis only to partnerships formed on or after September 23, 2002. Partnerships formed before September 23, 2002, however, may elect to change their taxable years to conform with these regulations. Such a change will be treated as a change to a required taxable year under § 4 of Rev. Proc. 2002–38 (2002–22 I.R.B. 1), or any successor, and the partnership will then be subject to the requirements of § 1.706–1(b)(6). Moreover, if an existing partnership terminates under the rules of section 708(b)(1)(B), the resulting partnership will be subject to the requirements of these regulations. Treasury and the IRS request comments on additional ways in which the administrative burdens associated with these regulations may be reduced.

The preamble to the 2001 Proposed Regulations requests comments on whether tax-exempt partners should be excluded for purposes of the minority interest rule. As no comments were received, the final regulations consider tax-exempt partners in determining whether the minority interest rule applies.

IV. Effective Date

The regulations under § 1.706–1(b)(5) relating to the taxable year of a partnership with tax-exempt partners apply to taxable years beginning on or after July 23, 2002. For taxable years beginning before July 23, 2002, see § 1.706–3T as contained in 26 CFR part 1 revised April 1, 2002.

The regulations under § 1.706–1(b)(6) relating to the taxable year of a partnership with foreign partners are applicable for taxable years of partnerships (other than existing partnerships as defined in § 1.706–1(b)(6)(v)) beginning on or after July 23, 2002.

The regulations under § 1.706–1(b)(11) relating to the effect of partner elections under section 444 are applicable for taxable years of partnerships beginning on or after July 23, 2002. For taxable years beginning before July 23, 2002, see § 1.706–3T as contained in 26 CFR part 1 revised April 1, 2002.

V. Transitional Relief for Existing Partnerships With Foreign Partners

The 2001 Proposed Regulations recognize that a potential hardship exists for partners of an existing partnership that changes its taxable year to comply with § 1.706–1(b)(6). If the

change results in two partnership taxable years ending within a partner's single taxable year, that partner could experience a bunching of more than 12 months of partnership income in a single taxable year. In order to avoid potential hardships, the 2001 Proposed Regulations incorporate the transitional rules of § 1.702–3T to allow the gain recognition to be spread over a four-year period. A partnership that uses this transitional rule is required to take into account all items of income, gain, loss, deduction and credit ratably over the four-year period.

Unlike the 2001 Proposed Regulations, these regulations do not require that existing partnerships change their taxable years to conform to the regulations. Because the regulations do not require existing partnerships to change their taxable years, the need for transitional relief is less imperative. Nevertheless, to encourage existing partnerships to change their taxable years to conform to these regulations, Treasury and the IRS have retained the transitional rule for any partnership that elects to apply the regulations in its first taxable year beginning on or after July 23, 2002.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

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

1. The authority citation for part 1 continues to read in part as follows:

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

2. In § 1.706–1, paragraphs (b)(5) and (b)(6) are revised and paragraph (b)(11) is added to read as follows:

§ 1.706–1 Taxable years of partner and partnership.

* * * * *

(b) * * *

(5) *Taxable year of a partnership with tax-exempt partners*—(i) *Certain tax-exempt partners disregarded.* In determining the taxable year (the current year) of a partnership under section 706(b) and the regulations thereunder, a partner that is tax-exempt under section 501(a) shall be disregarded if such partner was not subject to tax, under chapter 1 of the Internal Revenue Code, on any income attributable to its investment in the partnership during the partnership's taxable year immediately preceding the current year. However, if a partner that is tax-exempt under section 501(a) was not a partner during the partnership's immediately preceding taxable year, such partner will be disregarded for the current year if the partnership reasonably believes that the partner will not be subject to tax, under chapter 1 of the Internal Revenue Code, on any income attributable to such partner's investment in the partnership during the current year.

(ii) *Example.* The provisions of paragraph (b)(5)(i) of this section may be illustrated by the following example:

Example. Assume that partnership A has historically used the calendar year as its taxable year. In addition, assume that A is owned by 5 partners, 4 calendar year individuals (each owning 10 percent of A's profits and capital) and a tax-exempt organization (owning 60 percent of A's profits and capital). The tax-exempt organization has never had unrelated business taxable income with respect to A and has historically used a June 30 fiscal year. Finally, assume that A desires to retain the calendar year for its taxable year beginning January 1, 2003. Under these facts and but for the special rule in paragraph (b)(5)(i) of this section, A would be required under section 706(b)(1)(B)(i) to change to a year ending June 30, for its taxable year beginning January 1, 2003. However, under the special rule provided in paragraph (b)(5)(i) of this section the partner that is tax-exempt is disregarded, and A must retain the calendar year, under section 706(b)(1)(B)(i), for its taxable year beginning January 1.

(iii) *Effective date.* The provisions of this paragraph (b)(5) are applicable for taxable years beginning on or after July 23, 2002. For taxable years beginning before July 23, 2002, see § 1.706–3T as contained in 26 CFR part 1 revised April 1, 2002.

(6) *Certain foreign partners disregarded*—(i) *Interests of disregarded foreign partners not taken into account.* In determining the taxable year (the current taxable year) of a partnership under section 706(b) and the regulations thereunder, any interest held by a disregarded foreign partner is not taken into account. A foreign partner is a disregarded foreign partner 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 (or, if such partner was not a partner during the partnership's immediately preceding taxable year, the partnership reasonably believes that the partner will be allocated any such income during the current taxable year) and taxation of that income is not otherwise precluded under any U.S. income tax treaty.

(ii) *Definition of foreign partner.* For purposes of this paragraph (b)(6), 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.

(iii) *Minority interest rule.* If each partner that is not a disregarded foreign partner under paragraph (b)(6)(i) of this section (regarded partner) holds less than a 10-percent interest, and the regarded partners, in the aggregate, hold less than a 20-percent interest in the capital or profits of the partnership, then paragraph (b)(6)(i) of this section does not apply. In determining ownership in a partnership for purposes of this paragraph (b)(6)(iii), each regarded partner is treated as owning any interest in the partnership owned by a related partner. For this purpose, partners are treated as related if they are related within the meaning of sections 267(b) or 707(b) (using the language ''10 percent'' instead of ''50 percent'' each place it appears). However, 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 regarded partner.

(iv) *Example.* The provisions of paragraph (b)(6) 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 (b)(6)(i) 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)(6)(iii) of this section applies, and partnership B must adopt the March 31 fiscal year for Federal tax purposes.

(v) *Effective date*—(A) *Generally.* The provisions of this paragraph (b)(6) are applicable for the first taxable year of a partnership other than an existing partnership that begins on or after July 23, 2002. For this purpose, an existing partnership is a partnership that was formed prior to September 23, 2002.

(B) *Voluntary change in taxable year.* An existing partnership may change its taxable year to a year determined in accordance with this section. An existing partnership that makes such a change will cease to be exempted from the requirements of paragraph (b)(6) of this section.

(C) *Subsequent sale or exchange of interests.* If an existing partnership terminates under section 708(b)(1)(B), the resulting partnership is not an existing partnership for purposes of paragraph (b)(6)(v)(A) of this section.

(D) *Transition rule.* If, in the first taxable year beginning on or after July 23, 2002, an existing partnership voluntarily changes its taxable year to a year determined in accordance with this paragraph (b)(6), then the partners of that partnership may apply the provisions of § 1.702–3T to take into account all items of income, gain, loss, deduction, and credit attributable to the partnership year of change ratably over a four-year period.

* * * * *

(11) *Effect of partner elections under section 444—(i) Election taken into account.* For purposes of section 706(b)(1)(B), any section 444 election by a partner in a partnership shall be taken into account in determining the taxable year of the partnership. See § 1.7519–1T(d), *Example (4).*

(ii) *Effective date.* The provisions of this paragraph (b)(11) are applicable for taxable years beginning on or after July 23, 2002. For taxable years beginning before July 23, 2002, see § 1.706–3T as contained in 26 CFR part 1 revised April 1, 2002.

* * * * *

§ 1.706–3T [Removed]

3. Section 1.706–3T is removed.

David A. Mader,

Deputy Commissioner of Internal Revenue.

Approved: July 16, 2002.

Pamela F. Olson,

Acting Assistant Secretary of the Treasury.

[FR Doc. 02–18455 Filed 7–22–02; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9008]

RIN 1545–AY45

Guidance Under Subpart F Relating to Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance under subpart F relating to partnerships. The final regulations are necessary in order to clarify the treatment of a controlled foreign corporation's (CFC) distributive share of partnership income under subpart F. The final regulations will affect United States shareholders of CFCs that have an interest in a partnership.

DATES: *Effective Dates:* July 23, 2002.

Applicability Dates: For dates of applicability, see § 1.702–1(a)(8)(ii), 1.952–1(g)(3), 1.954–1(g)(4), 1.954–2(a)(5)(v), 1.954–3(a)(6)(iii), 1.954–4(b)(2)(iii), 1.956–2(a)(3).

FOR FURTHER INFORMATION CONTACT: Jonathan A. Sambur, (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 20, 2000, the IRS and Treasury published in the **Federal Register** (65 FR 56836) proposed amendments to the regulations (REG–112502–00) under section 702 and subpart F of the Internal Revenue Code (Code). Those proposed regulations substantially restated rules in former proposed regulations, REG–104537–97 (63 FR 14613), that were withdrawn in REG–113909–98 (64 FR 37727). Written comments were solicited and a public hearing was scheduled for December 5, 2000. Several comments were received and are discussed below. No public hearing was requested, therefore the hearing was cancelled. After consideration of all the comments, the proposed regulations under section 702 and subpart F are adopted as revised by this Treasury decision.

Summary of Public Comments and Explanation of Revisions

A. § 1.702–1(a)(8)(ii) Characterization and Determination of Subpart F Income

Under the proposed regulations, gross income is characterized at the partnership level. If any part of the partnership's gross income is a type of income that would be subpart F income if received directly by partners that are CFCs, that part of the partnership's gross income must be separately taken into account by each partner under section 702. To the extent that the separately stated income results in subpart F income to the CFC partner, it will be taken into account in determining the CFC's total subpart F income for the taxable year.

The proposed regulations under section 702 clarify that an item must be separately taken into account when, if separately taken into account by any partner, the item would result in an income tax liability for that partner, or any other person, different from that which would result if the partner did not take the item into account separately.

One commentator noted that the proposed regulations are inconsistent with section 702(b), which requires that the character and source of an item of gross income be determined at the partnership level, because the proposed regulations require the determination of subpart F income as if the income had been earned by the CFC. That commentator asserted further that the addition of the phrase ''or for any other person'' in the first sentence of § 1.702–1(a)(8)(ii) goes beyond the regulatory authority provided in section 702(a)(7).

The IRS and Treasury believe there is ample statutory authority for these regulations. The regulations are based upon the authority of subchapter K and subpart F and the policies underlying those provisions. The legislative history of subchapter K provides that, for purposes of interpreting Internal Revenue Code provisions outside of subchapter K, a partnership may be treated as either an entity separate from its partners or an aggregate of its partners, depending on which characterization is more appropriate to carry out the purpose of the particular