Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Part 10

RIN 1515–AC88

Prototypes Used Solely for Product Development, Testing, Evaluation, or Quality Control Purposes

AGENCY: Customs Service, Department of the Treasury.

ACTION: Proposed rule.

SUMMARY: This document proposes to amend the Customs Regulations in order to establish rules and procedures under the Product Development and Testing Act of 2000 (PDTA). The purpose of the PDTA is to promote product development and testing in the United States by allowing the duty-free entry of articles, commonly referred to as prototypes, that are to be used exclusively in product development, testing, evaluation or quality control. The proposed regulations set forth the procedures for both the identification of those prototypes properly entitled to duty-free entry, as well as the permissible sale of such prototypes, following use in the United States, as scrap, waste, or for recycling.

DATES: Comments must be received on or before April 8, 2002.

ADDRESSES: Written comments may be addressed to and inspected at the Regulations Branch, U.S. Customs Service, 1300 Pennsylvania Avenue, NW., 3rd Floor, Washington, DC 20229.

FOR FURTHER INFORMATION CONTACT: Patricia Fitzpatrick, Office of Field Operations, (202–927–1106).

SUPPLEMENTARY INFORMATION:

Background

The Product Development and Testing Act of 2000 (''PDTA'') was enacted on November 9, 2000, as part of the Tariff Suspension and Trade Act of 2000 (''Act'') (Pub. L. 106–476). The provisions of the PDTA are found in sections 1431–1435 of the Act.

The purpose of the PDTA, as set forth in section 1432(b) of the Act, is to promote product development and testing in the United States by allowing the importation on a duty-free basis of articles commonly referred to as ''prototypes'' that are to be used exclusively for such product development, testing, evaluation or quality control.

By way of background, Congress has found, as stated in section 1432(a) of the Act, that a substantial amount of product development and testing occurs in the United States incident to the introduction and manufacture of new products both for domestic consumption and for export overseas. Product testing also occurs with respect to products already introduced into commerce in order to ensure that these products continue to meet specifications and perform as designed.

Until the enactment of the PDTA, prototype articles have generally been subject to Customs duty when imported, unless the articles were eligible for duty-free treatment under a special trade program, such as the North American Free Trade Agreement (NAFTA) (19 U.S.C. 3301 *et seq.*), or unless they were entered under a temporary importation bond (TIB) (subheading 9813.00.30, Harmonized Tariff Schedule of the United States (HTSUS)).

Furthermore, the value of these prototypes had to be included in the dutiable value of any imported production merchandise that resulted from the same design and development efforts to which the prototype articles themselves were dedicated. In effect, duty on a prototype good was assessed twice, once when the prototype was imported and a second time as part of the dutiable value of the related imported production merchandise. In this latter respect, the prototype would be considered to be an ''assist'' (see § 152.102(a)(1), Customs Regulations (19 CFR part 152)) and, as such, it would have to be included in the dutiable cost of any associated production merchandise that was later imported.

Congress found that assessing duty twice on prototypes unnecessarily inflates costs for U.S. businesses, thereby reducing their competitiveness and thus discourages development and testing in the United States, and favors its occurrence overseas, given that duty would only be charged once, upon the subsequent importation of the related production merchandise.

Consequently, to provide for the duty-free entry of prototypes, section 1433 of the Act amended the Harmonized Tariff Schedule of the United States (HTSUS) by inserting a new subheading 9817.85.01 in Subchapter XVII of Chapter 98, HTSUS. The free rate of duty, as noted in HTSUS subheading 9817.85.01, only pertains to products from a country that would be entitled to the ''Column 1'' rate of duty; otherwise, the relevant rate would be that applicable in the absence of HTSUS subheading 9817.85.01.)

Additionally, section 1433 of the Act amended the HTSUS by including a new U.S. Note 6 in Subchapter XVII of Chapter 98, HTSUS, that defines the term ''prototypes'' as used in HTSUS subheading 9817.85.01.

As defined in U.S. Note 6(a) to Subchapter XVII, the term ''prototypes'' means originals or models of articles that are either in the preproduction, production or postproduction stage and that are to be used exclusively for product development, testing, evaluation or quality control purposes. However, articles may not be classified as prototypes under HTSUS subheading 9817.85.01 if imported for automobile racing for purse, prize or commercial competition, as this activity is not considered to be product development, testing, evaluation, or quality control. For originals or models of articles that are in the production or postproduction stage to qualify as prototypes, they must be associated with a change in design from current production; this would include any refinement, advancement, improvement, development, or quality control in the product itself or in the means for producing the product.

Pursuant to U.S. Note 6(b) to Subchapter XVII of Chapter 98, HTSUS, prototypes may only be imported in limited noncommercial quantities based on industry practice. Moreover, any articles that are subject to quantitative restrictions, antidumping orders or countervailing duty orders may not be classified as prototypes. However, articles that are subject to licensing requirements, or that must comply with laws, rules or regulations administered by agencies other than Customs before being imported, may be entered as prototypes if they comply with all

applicable provisions of law and otherwise meet the definition of prototypes in U.S. Note 6(a) to Subchapter XVII of Chapter 98, HTSUS.

In addition, except as provided by the Secretary of the Treasury, prototypes or parts of prototypes may not be sold after importation into the United States or be incorporated into other products that are sold.

By this document, Customs proposes to amend the Customs Regulations to add a new § 10.91, pursuant to sections 1433–1435 of the Act, that would: (1) Establish requirements regarding the identification of prototypes at the time of their importation into the United States; and (2) establish requirements regarding the sale of prototypes, following their intended use in product development, testing and evaluation, as scrap, waste, or for recycling, if all applicable duties are tendered for sales of the prototypes, including prototypes and parts of prototypes that are incorporated into other products that are sold as scrap, waste, or recycled materials, at the rate of duty in effect for such scrap, waste, or recycled materials at the time of importation of the prototypes.

Declaration of Intent

Entry or withdrawal from warehouse for consumption of a prototype under HTSUS subheading 9817.85.01 may be accepted by the port director as an effective declaration that the articles will be used solely for the purposes stated in the subheading. If it is believed the circumstances so warrant, the port director may request the submission of proof of actual use, executed and dated by the importer. While there is no particular form proposed for this declaration, it may either be submitted in writing, or electronically as authorized by Customs, and must include a description of the use made of the articles set forth in sufficient detail so as to enable the port director to determine whether the articles have been entitled to entry as claimed.

Sale

The prototype or any part(s) of the prototype, after having been used for the purposes for which it was entered or withdrawn under HTSUS subheading 9817.85.01, may only be sold as scrap, waste, or for recycling. This includes a prototype or any part that is incorporated into another product, as scrap, waste, or recycled material. The importer must provide notice of such sale to the port director where the entry or withdrawal of the prototype was made. The notice of sale must be filed with a tender of appropriate duties within 10 business days of the sale.

While no particular form is required for the notice of sale, a consumption entry (Customs Form 7501), appropriately modified, or an electronic equivalent as authorized by Customs, may be used for this purpose. If the article sold is dutiable, the notice must also be accompanied by the payment of any duty due. In any case, a notice must be submitted in connection with the sale, whether or not duty is payable. If the notice is filed electronically, payment of any duty owed will be handled through the Automated Clearinghouse (see § 24.25, Customs Regulations (19 CFR 24.25)).

Such notice of sale must be executed by the importer, or other person having knowledge of the facts surrounding the sale, and it must include the following: the identity of the prototype, the consumption entry number under which it was imported, a copy of the declaration of actual use, and a description of the condition of the prototype following use for the intended permissible purposes, including any damage, degradation or deterioration to the article resulting from such use; the name and address of the party to whom the article was sold, and (if known) the use to which the party intends to put the article; the HTSUS subheading number for scrap, waste, or recycled material, as applicable, claimed in connection with the sale of the prototype, together with the corresponding rate of duty in effect at the time the prototype was originally imported for consumption; the value of the prototype article (if dutiable and the duty owed is based upon value); and the title of the party executing the declaration along with the date of execution.

For purposes of proposed § 10.91, with respect to any duty owed on prototypes or parts that are sold as scrap, or waste, or for recycling, where the duty owed is based upon value, the relevant value is the market value of the prototypes or parts, based upon their character and condition following use for the purposes prescribed in HTSUS subheading 9817.85.01. In this regard, the market value will generally be measured by the selling price. If a prototype or part of a prototype becomes a component of another product that is sold as scrap, waste, or recycled material, the relevant market value would be that portion of the selling price attributable to the component (that is, the prototype or part of prototype).

Required Recordkeeping

The importer must be prepared to submit to the Customs officer, if requested, such information, including any supporting documents, reports and records, as was necessary for the preparation of the declaration of use and, if applicable, the notice of sale. As previously noted, the submission of the notice of sale, if a sale occurs, is mandatory. The supporting documentary evidence for the notice of sale must be retained for a period of 5 years, as provided in § 163.4(a), Customs Regulations (19 CFR 163.4(a)), from the date of its filing in complete and proper form. Supporting records must be made available to the Customs officer upon request in accordance with § 163.6(a), Customs Regulations (19 CFR 163.6(a)). The notice, together with any related supporting evidence, may be subject to any verification that the port director reasonably deems necessary.

Effective Date

As noted in section 1435(1) and (2) of the Act, duty-free treatment under the PDTA applies to an entry of a prototype under HTSUS subheading 9817.85.01 made on or after the date of enactment of the Act (November 9, 2000) as well as to an entry of a prototype (as defined in U.S. Note 6(a) to Subchapter XVII of Chapter 98, HTSUS) made under subheading 9813.00.30, for which liquidation has not become final as of November 9, 2000.

In this latter regard, an entry under HTSUS subheading 9813.00.30 is made under a temporary importation bond (TIB), and an entry made under a TIB does not liquidate, given that a TIB entry does not involve liquidated duties (see § 10.31(h), Customs Regulations (19 CFR 10.31(h)). Rather, upon satisfaction of the terms and conditions of the TIB, charges under the bond are cancelled (see § 10.39, Customs Regulations (19 CFR 10.39)), and the related entry is ''closed'' (and not liquidated). Customs proposes in § 10.91 to give effect to the intent of Congress underlying section 1435(2) that certain prototypes already entered under a TIB as of November 9, 2000, be allowed to take advantage of duty-free entry under the PDTA.

To accomplish this, the importer must submit a written request, or an electronic equivalent as authorized by Customs, that a TIB entry under HTSUS subheading 9813.00.30, which had not been closed and for which the TIB period had not expired as of November 9, 2000, be converted instead into a duty-free consumption entry under HTSUS subheading 9817.85.01. Customs will so convert the TIB entry,

provided that the port director is satisfied that the entry is for articles that are ''prototypes'' as defined in U.S. Note 6(a) to Subchapter XVII of Chapter 98, HTSUS, and provided further that the entry was in effect and had not been closed (as opposed to having been finally liquidated), and the TIB period for the entry had not expired, as of November 9, 2000. When the TIB entry is so converted, the bond will be cancelled and the entry closed. The port director will provide a courtesy acknowledgment to the importer in writing or electronically once the conversion is complete.

Comments

Before adopting this proposal, consideration will be given to any written comments that are timely submitted to Customs. Customs specifically requests comments on the clarity of this proposed rule and how it may be made easier to understand. Comments submitted will be available for public inspection in accordance with the Freedom of Information Act (5 U.S.C. 552), § 1.4 of the Treasury Department Regulations (31 CFR 1.4), and § 103.11(b), Customs Regulations (19 CFR 103.11(b)), on regular business days between the hours of 9:00 a.m. and 4:30 p.m. at the Regulations Branch, U.S. Customs Service, 1300 Pennsylvania Avenue, NW. 3rd Floor, Washington, D.C.

Regulatory Flexibility Act and Executive Order 12866

The proposed regulations implement the terms and requirements of the PDTA which went into effect on November 9, 2000. The proposed amendments benefit the public by allowing the duty-free importation of prototypes that are to be used exclusively for product development and testing, thereby promoting such product development and innovation in the United States, as opposed to overseas. Accordingly, pursuant to the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), it is certified that, if adopted, the proposed amendments will not have a significant economic impact on a substantial number of small entities. Nor do the proposed amendments meet the criteria for a ''significant regulatory action'' as specified in E.O. 12866.

Paperwork Reduction Act

The collections of information encompassed within this proposed rule have previously been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) and assigned OMB Control Numbers 1515–0091 (Requirement of importer to maintain accurate, detailed records on use or other disposition of imported merchandise for ''actual use'' duty assessment requirements); and 1515–0109 (Certificate of importer to verify actual use of articles imported duty-free or at a reduced rate of duty under actual use provisions). These collections encompass a claim for duty-free entry for prototype articles imported for use exclusively for development, testing, product evaluation or quality control purposes. This proposed rule does not present any material change to the existing approved information collections.

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

Upon adoption of the proposed amendments as a final rule, part 178, Customs Regulations (19 CFR part 178), containing the list of approved information collections, will be revised to make reference to new § 10.91.

Drafting Information

The principal author of this document was Janet L. Johnson, Office of Regulations and Rulings, U.S. Customs Service. However, personnel from other offices participated in its development.

List of Subjects in 19 CFR Part 10

Customs duties and inspection, Imports, Preference programs, Reporting and recordkeeping requirements, Shipments.

Proposed Amendments to the Regulations

It is proposed to amend part 10, Customs Regulations (19 CFR part 10), as set forth below.

PART 10—ARTICLES CONDITIONALLY FREE, SUBJECT TO A REDUCED RATE, ETC.

1. The general authority citation for part 10 would continue to read as follows, and specific sectional authority for § 10.91 would be added in appropriate numerical order to read as follows:

Authority: 19 U.S.C. 66, 1202 (General Note 22, Harmonized Tariff Schedule of the United States (HTSUS)), 1321, 1481, 1484, 1498, 1508, 1623, 1624, 3314.

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§ 10.91 also issued under Pub. L. 106–476 (114 Stat. 2101), sections 1434, 1435;

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2. It is proposed to amend part 10 by adding after § 10.90 a new center heading entitled ''Prototypes'' followed by a new § 10.91 to read as follows:

Prototypes

§ 10.91 Prototypes used exclusively for product development and testing.

(a) *Duty-free entry; declaration of intent; suspension of liquidation.*

(1) *Entry or withdrawal for consumption.* Articles defined as ''prototypes'' and meeting the other requirements prescribed in paragraph (b) of this section may be entered or withdrawn from warehouse for consumption, duty-free, under subheading 9817.85.01, Harmonized Tariff Schedule of the United States (HTSUS), on Customs Form 7501 or an electronic equivalent. A separate entry or withdrawal must be made for a qualifying prototype article each time the article is imported/reimported to the United States.

(2) *Importer declaration.*—(i) *Entry accepted as declaration.* Entry or withdrawal from warehouse for consumption under HTSUS subheading 9817.85.01 may be accepted by the port director as an effective declaration that the articles will be used solely for the purposes stated in the subheading.

(ii) *Proof of Actual Use.* If it is believed the circumstances so warrant, the port director may request the submission of proof of actual use, executed and dated by the importer. While there is no particular form for this declaration, it may either be submitted in writing, or electronically as authorized by Customs, and must include the following:

(A) A description of the use to be made of the articles set forth in sufficient detail so as to enable the port director to determine whether the articles have been entitled to entry as claimed;

(B) A statement that the articles are not to be put to any other use; and

(C) A statement that neither the articles nor any parts of the articles will be sold, or be incorporated into other products that are sold, after the articles have been entered or withdrawn from warehouse for consumption and prior to the completion of their use as provided in HTSUS subheading 9817.85.01 (see paragraph (b)(2)(ii) of this section).

(b) *Articles classifiable as prototypes.*—(1) *Prototypes defined.* In accordance with U.S. Note 6(a) to Subchapter XVII of Chapter 98, HTSUS, the term ''prototypes'' means originals or models of articles that:

(i) Are either in the preproduction, production or postproduction stage and

are to be used exclusively for development, testing, product evaluation, or quality control purposes (not including automobile racing for purse, prize or commercial competition); and

(ii) In the case of originals or models of articles that are either in the production or postproduction stage, are associated with a design change from current production (including a refinement, advancement, improvement, development or quality control in either the product itself or the means of producing the product).

(2) *Additional requirements.* In accordance with U.S. Note 6(b) to Subchapter XVII of Chapter 98, HTSUS, the following additional restrictions apply to articles that may be classified as prototypes:

(i) *Importations limited.* Prototypes may be imported pursuant to this section only in limited noncommercial quantities in accordance with industry practice.

(ii) *Sale prohibited after entry and prior to use.* Prototypes or parts of prototypes may not be sold, or be incorporated into other products that are sold, after the prototypes have been entered or withdrawn from warehouse for consumption under HTSUS subheading 9817.85.01, unless, after having been used for the purposes for which they were entered or withdrawn from warehouse under HTSUS subheading 9817.85.01, such prototypes or any part(s) of the prototypes may be sold as scrap, waste, or for recycling, as prescribed in paragraph (d) of this section.

(iii) *Articles subject to laws of another agency.* Articles that are subject to licensing requirements, or that must comply with laws, rules or regulations administered by an agency other than Customs before being imported, may be entered as prototypes pursuant to this section if they meet all applicable provisions of law and otherwise meet the definition of prototypes in paragraph (b)(1) of this section.

(iii) *Articles excluded from being prototypes.* Articles subject to quantitative restrictions, antidumping orders or countervailing duty orders are excluded from being classified as prototypes under this section.

(c) *Sale of prototype following use.*—(1) *Sale.* Prototypes or any part(s) of prototypes, after having been used for the purposes for which they were entered or withdrawn under HTSUS subheading 9817.85.01, may only be sold as scrap, waste, or for recycling. This includes a prototype or any part thereof that is incorporated into another product, as scrap, waste, or recycled material. In addition, prototypes or their parts may only be sold as scrap, waste, or for recycling, upon payment of applicable duty on the prototypes or parts, at the rate of duty in effect for such scrap, waste, or recycled materials at the time the prototypes were entered or withdrawn for consumption.

(2) *Notice of sale required.* If, after a prototype has been used for the purposes contemplated in HTSUS subheading 9817.85.01, the prototype or any part(s) of the prototype (including a prototype or any part that is incorporated into another product) is sold as scrap, waste, or for recycling, the importer must provide notice of such sale to the port director where the entry or withdrawal of the prototype was made. A notice must be submitted in connection with the sale, whether or not duty is payable. The notice, if applicable, should not be submitted prior to the submission of the declaration of actual use (see paragraph (c)(1) of this section).

(3) *Form and content of notice; tender of duty.* While no particular form is required for the notice of sale, a consumption entry (Customs Form 7501), appropriately modified, or an electronic equivalent as authorized by Customs, may be used for this purpose. The notice must be filed within 10 business days of the sale. If the article sold is dutiable, the payment of any duty due must be forwarded together with the notice (see paragraph (d)(1) of this section). If the notice is filed electronically, payment of any duty owed will be handled through the Automated Clearinghouse (see § 24.25 of this chapter). In addition, the notice of sale must be executed by the importer, or other person having knowledge of the facts surrounding the sale, and must include the following:

(i) The identity of the prototype, the consumption entry number under which it was imported, a copy of the declaration of actual use, along with a description of the condition of the prototype following use for the intended permissible purposes, including any damage, degradation or deterioration to the article resulting from such use;

(ii) The name and address of the party to whom the article was sold, and (if known) the use to which the party intends to put the article;

(iii) The HTSUS subheading number for scrap, waste, or recycled material, as applicable, claimed in connection with the sale of the prototype, together with the corresponding rate of duty in effect at the time the prototype was originally imported for consumption;

(iv) The value of the prototype article (if dutiable and the duty owed is based upon value) (see paragraph (e)(2) of this section); and

(v) The title of the party executing the declaration and the date of execution.

(4) *Failure to file timely notice.* Failure to file timely the notice of sale or to deposit the appropriate duty shall be a breach of the importer's bond and result in the assessment of liquidated damages.

(e) *Recordkeeping; retention and production.*—(1) *Recordkeeping.* The importer must be prepared to submit to the Customs officer, if requested, such information, including any supporting documents, reports and records, as was necessary for the preparation of the declaration of use in paragraph (a)(2)(ii) of this section, and the notice of sale in paragraph (c)(3) of this section. The submission of the notice of sale is mandatory if a sale occurs after importation. The notice, together with any related supporting evidence, may be subject to such verification as the port director reasonably deems necessary. Such documentary evidence must be made available to the Customs officer, upon request, for a period of five years from the date of filing in complete and proper form, the declaration of use, if requested, and, if applicable, the notice of sale, as provided in § 163.4 of this chapter. The supporting records must be made available to the Customs officer upon request in accordance with § 163.6 of this chapter. The specific documentary evidence necessary to support notice of sale, if applicable, consists of:

(i) The identity of the prototype, including the identity of the consumption entry under which it was imported, and a description of the condition of the prototype following use for the intended permissible purposes, including any damage, degradation or deterioration to the article resulting from such use;

(ii) The name and address of the party to whom the article was sold, and (if known) the use to which the party intends to put the article;

(iii) The HTSUS subheading number for scrap, waste, or recycled material, as applicable, claimed in connection with the sale of the prototype, together with the corresponding rate of duty in effect at the time the prototype was originally imported for consumption;

(iv) The value of the prototype article (if dutiable and the duty owed is based upon value) (see paragraph (e)(2) of this section); and

(v) The title of the party executing the declaration and the date of execution.

(2) *Relevant value for used prototype or parts sold.* For purposes of this section, with respect to any duty owed

on prototypes or parts of prototypes that are sold as scrap, or waste, or for recycling, where the duty owed is based upon value, the relevant value is the market value of the prototypes or parts, based upon their character and condition following use for the purposes prescribed in HTSUS subheading 9817.85.01. The market value will generally be measured by the selling price. Should a prototype or part of a prototype become a component of another product that is sold as scrap, waste, or recycled material, the relevant market value would be that portion of the selling price attributable to the component (prototype or part) as provided in this paragraph.

(f) *Articles admitted under TIB.*—(1) *Duty-free entry available.* Under the procedure presented in paragraph (f)(2) of this section, an entry of an article made under a temporary importation bond (TIB) solely for testing, experimental or review purposes under HTSUS subheading 9813.00.30 may be converted into a duty-free entry under HTSUS subheading 9817.85.01, if the following conditions exist:

(i) The article meets the definition for ''prototypes'' in paragraph (b) of this section (U.S. Note 6(a) to Subchapter XVII, Chapter 98, HTSUS); and

(ii) The TIB entry for the article was in effect and had not been closed, and the TIB period for the article had not expired, as of November 9, 2000.

(2) *Procedure for converting TIB entry to duty-free entry.*—(i) *Importer request.* The importer must submit a written request, or an electronic equivalent as authorized by Customs, that a TIB entry made under HTSUS subheading 9813.00.30, which was in effect and had not been closed, and for which the TIB period had not expired, as of November 9, 2000, be converted instead into a duty-free consumption entry under HTSUS subheading 9817.85.01.

(ii) *Action by Customs.* Customs will convert the TIB entry under HTSUS subheading 9813.00.30 to a duty-free entry under HTSUS subheading 9817.85.01, provided that the port director is satisfied that the conditions set forth in paragraphs (f)(1)(i) and (f)(1)(ii) of this section have been met. When the TIB entry is converted, the bond will be cancelled and the entry closed. Once the conversion is complete, the port director will provide a courtesy acknowledgment to this effect to the importer in writing or electronically.

Robert C. Bonner,

Acting Commissioner of Customs.

Approved: March 5, 2002.

Timothy E. Skud,

Acting Deputy Assistant Secretary of the Treasury.

[FR Doc. 02–5557 Filed 3–7–02; 8:45 am]

BILLING CODE 4820–02–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–118861–00]

RIN 1545–AY49

Application of Section 338 to Insurance Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that apply to a deemed sale or acquisition of an insurance company's assets pursuant to an election under section 338 of the Internal Revenue Code, to a sale or acquisition of an insurance trade or business subject to section 1060, and to the acquisition of insurance contracts through assumption reinsurance. It also contains proposed regulations under section 381 concerning the effect of certain corporate liquidations and reorganizations on certain tax attributes of insurance companies. The proposed regulations apply to insurance companies and to corporations selling and purchasing stock of insurance companies. This document also provides a notice of public hearing on the proposed regulations.

DATES: Written or electronic comments and requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for September 18, 2002, must be received by August 28, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–118861–00), room 5226, Internal Revenue Service, POB 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:ITA:RU (REG–118861–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20044. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at www.irs.gov/regs. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Gary Geisler, (202) 622–3970, or Mark Weiss, (202) 622–7790, concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Overview of the Proposed Regulations

These proposed regulations apply to taxable asset acquisitions and dispositions of insurance businesses and companies, many of which occur by virtue of elections under section 338 of the Internal Revenue Code (Code). A number of questions have arisen concerning the tax consequences of such transactions, and numerous requests for clarification were received in response to the proposal of regulations under sections 338 and 1060 (REG–107069–97, 1999–2 C.B. 346, 64 FR 43462) in 1999. The Treasury decision finalizing those regulations in February, 2001, announced the intention of the IRS and Treasury to provide guidance regarding the treatment of a deemed asset sale by an insurance company in a separate project (TD 8940, 2001–15 I.R.B. 1016, 1017, 66 FR 9925). That additional guidance is proposed in this document.

In taxable asset acquisitions governed by section 338 or 1060 generally, the total cost of the acquisition is apportioned among specific assets under a residual method that extrapolates the price of each asset from the overall price of the transaction (including assumed liabilities), ranking the assets in classes for priority of allocation, with goodwill and going concern value (Class VII assets) ranked last and section 197 intangibles (Class VI assets) ranked next to last. *See* §§ 1.338–6(b)(2) and 1.1060–1(a)(1). Rights under an insurance company's outstanding insurance contracts (commonly known as insurance in force) that are acquired through assumption reinsurance as part of a taxable asset acquisition generally are intangible assets that constitute section 197 intangibles within the meaning of section 197(d) and, hence, are classified as Class VI assets under § 1.338–6(b)(2)(vi).