

address of each customer, together with information as required by forms and regulations. Section 6045(d) provides that brokers who transfer a customer's securities for use in a short sale or similar transaction, and receive payments in lieu of a dividend, tax-exempt interest, or other items set forth in regulations (substitute payments), must furnish the customer with a written statement identifying the payment as being in lieu of the dividend, tax-exempt interest, or other item. This section authorizes the Secretary to prescribe regulations that require brokers to file information returns that include the information contained in the written statement.

Section 1.6045-2 of the existing Income Tax Regulations provides rules for reporting substitute payments under section 6045(d). In general, § 1.6045-2(a)(3)(i) of the existing regulations excludes payments in lieu of dividends received by a broker on behalf of an individual from the broker reporting requirements of section 6045(d). Section 1.6045-2(a)(3)(ii) of the existing regulations requires reporting for certain dividend substitute payments received by a broker on behalf of an individual, such as payments in lieu of exempt interest dividends distributed by regulated investment companies.

These regulations contain amendments to the existing regulations to require reporting under section 6045(d) for payments in lieu of dividends made to individuals on or after January 1, 2003. For taxable years beginning on or after January 1, 2003, brokers must use Form 1099-MISC, "Miscellaneous Income", to report substitute payments to individuals, including payments in lieu of dividends.

The IRS issued interim guidance regarding provisions of the JGTRRA that affect information reporting for payments in lieu of dividends in Notice 2003-67 (2003-40 I.R.B. 752). The notice also provided guidance on the definition of loanable shares and the allocation and selection of transferred shares (that is, shares giving rise to payments in lieu of dividends to customers). The IRS intends to issue comprehensive regulations amending § 1.6045-2 in the future. The IRS anticipates that these regulations will define payments in lieu of dividends, provide rules for determining loanable shares, and provide rules for allocating and selecting transferred shares to customers. Pending issuance of further amendments to § 1.6045-2 of the existing regulations, brokers may rely on Notice 2003-67 to comply with the

requirements of the JGTRRA and section 6045(d).

In addition, pending issuance of further amendments to § 1.6045-2, the IRS will permit brokers to continue to use the rules of § 1.6045-2 of the existing regulations for allocating transferred shares to customers. A broker may continue to allocate transferred shares to shares of stock that the broker has borrowed under a security agreement with the customer. In addition, if a broker uses the lottery method of allocation and selection of loanable shares specified in § 1.6045-2(f)(2)(ii), the broker may make the selection of the transferred shares within the individual pool described in § 1.6045-2(f)(2)(ii)(C) using the methods of selection of transferred shares used within the nonindividual pool as prescribed in § 1.6045-2(f)(2)(ii)(B).

#### Special Analyses

These final regulations are necessary to provide brokers and taxpayers with immediate guidance regarding provisions in the JGTRRA that affect information reporting for substitute payments in lieu of dividends. The regulations apply to information returns required to be filed, and information statements required to be furnished, after December 31, 2003. Based on these considerations, it is determined that these final regulations will provide brokers and taxpayers with the necessary guidance and authority to comply with the tax laws. Because of the need for immediate guidance, notice and public procedure are impracticable and contrary to the public interest pursuant to 5 U.S.C. 553(b)(B) and delayed effective date is not required pursuant to 5 U.S.C. 553(d)(3).

Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act, 5 U.S.C. 601 (*et seq.*) do not apply. Further, 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. Pursuant to section 7805(f) of the Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Drafting Information

The principal author of these regulations is Michael Hara, Office of Associate Chief Counsel (Procedures and Administration), Administrative Provisions and Judicial Practice.

#### 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 1.6045-2 is amended by:

- 1. Paragraph (a)(3)(i) is revised.
- 2. The heading for paragraph (a)(3)(ii) is revised.

The revisions read as follows:

#### § 1.6045-2 Furnishing statement required with respect to certain substitute payments.

(a) \* \* \*

(3) \* \* \* (i) *In general.* Except as otherwise provided in paragraph (a)(3)(ii) of this section, for taxable years beginning before January 1, 2003, a broker that receives a substitute payment in lieu of a dividend on behalf of a customer who is an individual ("individual customer") need not furnish a statement to the customer.

(ii) *Reporting for certain dividends.*

\* \* \*

\* \* \* \* \*

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

Approved: December 18, 2003.

**Pamela F. Olson,**

*Assistant Secretary of the Treasury.*

[FR Doc. 03-31671 Filed 12-24-03; 8:45 am]

BILLING CODE 4830-01-P

#### DEPARTMENT OF THE TREASURY

#### Internal Revenue Service

#### 26 CFR Part 301

[TD 9106]

RIN 1545-AW99

#### Awards of Attorney's Fees and Other Costs Based Upon Qualified Offers

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

**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document contains final regulations relating to the qualified offer rule, including the requirements that an offer must satisfy to be treated as a

qualified offer under section 7430(g) and the requirements that a taxpayer must satisfy to qualify as a prevailing party by reason of having made a qualified offer. The regulations implement certain changes made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998. The final regulations affect taxpayers seeking attorney's fees and costs.

**DATES: Effective Date:** These regulations are effective December 24, 2003.

**Applicability Date:** These regulations apply to qualified offers postmarked or delivered after December 24, 2003, in administrative or court proceedings described in section 7430.

**FOR FURTHER INFORMATION CONTACT:** Tami C. Belouin (202) 622-7950 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

These final regulations contain amendments to the Procedure and Administration Regulations (26 CFR part 301) reflecting changes to section 7430 made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 686), to recover reasonable administrative and litigation costs in a court proceeding with respect to the determination or refund of any tax, interest or penalty. Proposed and temporary regulations under sections 7430(c)(4)(E) and 7430(g) were contemporaneously issued on January 3, 2001 (REG-121928-98, TD 8922, C.B. 2001-1 [66 FR 725]). Written comments were submitted in response to the proposed regulations and are discussed in more detail below. The proposed regulations are adopted as revised by this Treasury decision.

**Explanation of Revisions and Summary of Comments**

These final regulations generally adopt the provisions of the proposed regulations. The changes to the proposed regulations reflected in these final regulations, as well as the comments received, are discussed below.

*1. Adjustments Affected by the Outcome of Another Proceeding*

A taxpayer's tax liability may be affected by the outcome of a separate court or administrative proceeding. The proposed regulations stated that the portion of the liability to be fully resolved, by stipulation of the parties, through another proceeding is ignored for purposes of applying the qualified offer rule. One commentator requested

clarification regarding this rule. The final regulations clarify this rule and state that the types of proceeding contemplated include, but are not limited to, state or Federal court proceedings. For example, a taxpayer's tax liability may be affected by the outcome of a separate court proceeding, such as a probate, tort liability, or trademark action.

*2. Specified Amount of Offer*

The proposed regulations provided that a qualified offer must state a specific dollar amount. Commentators noted that there are instances in which it would be difficult to calculate the taxpayer's tax liability and offer a specific dollar amount. To address those situations, the final regulations provide that a qualified offer may specify either a dollar amount of liability or a percentage of the adjustments at issue.

*3. Requirement To Disclose All Relevant Information*

In order for an offer to be treated as a qualified offer, the proposed regulations required a taxpayer to disclose all relevant information concerning any issue raised by the taxpayer subsequent to the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals that remained unresolved at the time the qualified offer was made. This disclosure had to occur contemporaneously with or prior to the making of the qualified offer. One commentator requested that this requirement be modified to lower the standard. The final regulations do not adopt this comment because the proposed regulations reflected the standard set out in Treas. Reg. § 301.7430-1 for exhaustion of administrative remedies.

*4. End of Qualified Offer Period*

One commentator suggested that if a case is removed from the trial calendar within 30 days of the trial date, the period for making a qualified offer should be reopened. The final regulations do not adopt this comment. The Treasury Department and the IRS do not believe that the purpose of the statute would be furthered if a taxpayer were permitted to submit a qualified offer after the period for doing so has expired, even if the case subsequently is continued. Like the statute of limitations, once the qualified offer period has expired, it should not be revived.

*5. Multiple Tax Years*

The proposed regulations do not specifically address the requirements for making a valid qualified offer when multiple tax years are at issue in a court or administrative proceeding. One commentator requested clarification of the application of the qualified offer rule in these situations. The final regulations provide that if adjustments in different tax years arise from separate and distinct issues such that the resolution of issues in one or more tax years will not affect the taxpayer's liability in one or more of the other years at issue in the proceeding, then a qualified offer may be made for less than all of the tax years involved in the proceeding. A qualified offer, however, must resolve all of the issues for the tax years covered by the offer and also must cover all tax years in the proceeding affected by those issues. A tax year (affected year) is affected by an issue if the treatment of the issue in another tax year involved in the proceeding necessarily affects the treatment of the issue in the affected year. The final regulations include three new examples illustrating the operation of the qualified offer rule in cases involving multiple tax years.

*6. Settlement After Certain Court Rulings*

A federal tax case may be settled after a court has ruled on a motion relating to the merits of one or more of the adjustments covered by a qualified offer, even if the ruling does not fully resolve those adjustments. For example, a court's granting of a motion for partial summary judgment may resolve the underlying legal issue for an adjustment covered by a qualified offer but still leave open issues of substantiation or valuation. The parties at that time may resolve the adjustment based on the court's ruling and the parties' evaluation of the remaining issues not addressed by the court's ruling that affect that adjustment. The final regulations provide that if one or more adjustments covered by a qualified offer are settled following a ruling by the court that substantially resolves those adjustments, then those adjustments will not be treated as having been settled prior to the entry of the judgment by the court and instead will be treated as amounts included in the judgment as a result of the court's determinations. Whether an adjustment covered by a qualified offer is substantially resolved by a court ruling will depend on the facts and circumstances, including the scope of the ruling and the nature and importance of the issues affecting the

adjustment that remain to be resolved after the court ruling. The final regulations further provide, however, that rulings relating to discovery, admissibility of evidence, and burden of proof are not treated as rulings that substantially resolve adjustments covered by a qualified offer. These changes have been made in response to the Tax Court's opinion in *Gladden v. Commissioner*, 120 T.C. 446 (2003). The Department of Treasury and the IRS will give further consideration to this issue and may issue additional guidance regarding the matter in the future.

#### 7. Spousal Defenses

The proposed regulations do not address specifically how spousal defenses affect the qualified offer rule. The preamble to the temporary regulations stated that the qualified offer rule applies in multiple taxpayer situations, such as those involving joint returns, but did not address the potential aggregation or segregation of the qualified offer or liability in situations that may present special circumstances, such as claims for innocent spouse relief. Commentators requested more specific rules addressing multiple taxpayer situations. The Treasury Department and the IRS have decided not to include additional rules involving multiple taxpayer situations in the final regulations. As the law in this area continues to evolve, the Treasury Department and the IRS may give further consideration to the issues raised and may issue additional guidance regarding how the qualified offer rule applies in these situations.

#### 8. Recovery of Fees Relating to Settled Issues

The proposed regulations provided that a prevailing party may not recover fees under the qualified offer rule for any issue that is settled. Recovery is limited to issues that are actually determined by a court. One commentator recommended that the final regulations permit the recovery of fees attributable to adjustments that are settled. The final regulations do not adopt this comment. Section 7430(c)(4)(E)(ii)(I) provides that any case resolved pursuant to a settlement is not eligible for recovery of fees under the qualified offer rule. The qualified offer rule was enacted to encourage settlements. Requiring the government to pay administrative and litigation costs with respect to issues resolved exclusively pursuant to a settlement would be contrary to that goal.

#### 9. Delivery of Qualified Offer to the Proper Party

The proposed regulations specify where an offer must be delivered in order to be treated as a qualified offer. One commentator requested further clarification of these provisions and greater flexibility with respect to delivery locations. The Treasury Department and the IRS have considered this comment but no change has been made to the regulations because the regulations already provide specific instructions for the delivery of an offer under a variety of circumstances, as well as a default location for all other situations. Thus, the provision is sufficiently comprehensive. With respect to the request for greater flexibility, the comment was not adopted because it is important that a qualified offer be received by the office with jurisdiction over the case at the time the qualified offer is made in order that the government may act expeditiously on the offer. The locations specified in the regulations are designed to achieve that objective.

#### 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) does not apply to these regulations and, because these regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Drafting Information

The principal author of these regulations is Tami C. Belouin, Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

#### List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 301 is amended as follows:

#### PART 301—PROCEDURE AND ADMINISTRATION

■ **Paragraph 1.** The authority citation for part 301 continues to read in part as follows:

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

■ **Par. 2.** Section 301.7430-7 is added to read as follows:

#### § 301.7430-7 Qualified offers.

(a) *In general.* Section 7430(c)(4)(E) (the qualified offer rule) provides that a party to a court proceeding satisfying the timely filing and net worth requirements of section 7430(c)(4)(A)(ii) shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted the last qualified offer of the party as defined in section 7430(g). For purposes of this section, the term *judgment* means the cumulative determinations of the court concerning the adjustments at issue and litigated to a determination in the court proceeding. In making the comparison between the liability under the qualified offer and the liability under the judgment, the taxpayer's liability under the judgment is further modified by the provisions of paragraph (b)(3) of this section. The provisions of the qualified offer rule do not apply if the taxpayer's liability under the judgment, as modified by the provisions of paragraph (b)(3) of this section, is determined exclusively pursuant to a settlement, or to any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to the Internal Revenue Code (Code), and any action to restrain disclosure under section 6110(f). If the qualified offer rule applies to the court proceeding, the determination of whether the liability under the qualified offer would have equaled or exceeded the liability pursuant to the judgment is made by reference to the last qualified offer made with respect to the tax liability at issue in the administrative or court proceeding. An award of reasonable administrative and litigation costs under the qualified offer rule only includes those costs incurred on or after the date of the last qualified offer and is limited

to those costs attributable to the adjustments at issue at the time the last qualified offer was made that were included in the court's judgment other than by reason of settlement. The qualified offer rule is inapplicable to reasonable administrative or litigation costs otherwise awarded to a taxpayer who is a prevailing party under any other provision of section 7430(c)(4). This section sets forth the requirements to be satisfied for a taxpayer to be treated as a prevailing party by reason of the taxpayer making a qualified offer, as well as the circumstances leading to the application of the exceptions, special rules, and coordination provisions of the qualified offer rule. Furthermore, this section sets forth the elements necessary for an offer to be treated as a qualified offer under section 7430(g).

(b) *Requirements for treatment as a prevailing party based upon having made a qualified offer*—(1) *In general.* In order to be treated as a prevailing party by reason of having made a qualified offer, the liability of the taxpayer for the type or types of tax and the taxable year or years at issue in the proceeding (as calculated pursuant to paragraph (b)(2) of this section), based on the last qualified offer (as defined in paragraph (c) of this section) made by the taxpayer in the court or administrative proceeding, must equal or exceed the liability of the taxpayer pursuant to the judgment by the court for the same type or types of tax and the same taxable year or years (as calculated pursuant to paragraph (b)(3) of this section). Furthermore, the taxpayer must meet the timely filing and net worth requirements of section 7430(c)(4)(A)(ii). If all of the adjustments subject to the last qualified offer are settled prior to the entry of the judgment by the court, the taxpayer is not a prevailing party by reason of having made a qualified offer. The taxpayer may, however, still qualify as a prevailing party if the requirements of section 7430(c)(4)(A) are met. If one or more adjustments covered by a qualified offer (see paragraph (c)(3)) are settled following a ruling by the court that substantially resolves those adjustments, then those adjustments will not be treated as having been settled prior to the entry of the judgment by the court and instead will be treated as amounts included in the judgment as a result of the court's determinations. For purposes of the preceding sentence, rulings relating to discovery, admissibility of evidence, and burden of proof are not rulings that substantially

resolve adjustments covered by a qualified offer.

(2) *Liability under the last qualified offer.* For purposes of paragraph (b)(1) of this section, the taxpayer's liability under the last qualified offer is the change in the taxpayer's liability that would have resulted if the United States had accepted the taxpayer's last qualified offer on all of the adjustments that were at issue in the administrative or court proceeding at the time that the offer was made compared to the amount shown on the return or returns (or as previously adjusted). The portion of a taxpayer's liability that is attributable to adjustments raised by either party after the making of the last qualified offer is not included in the calculation of the liability under that offer. The taxpayer's liability under the last qualified offer is calculated without regard to adjustments that the parties have stipulated will be resolved in accordance with the outcome of a separate pending Federal, state, or other judicial or administrative proceeding. For example, the parties may stipulate that the taxpayer's liability will be resolved in accordance with the outcome of an alternative dispute resolution proceeding or a separate court proceeding, such as a probate, tort liability, or trademark action. Furthermore, the taxpayer's liability under the last qualified offer is calculated without regard to interest, unless the taxpayer's liability for, or entitlement to, interest is a contested issue in the administrative or court proceeding and is one of the adjustments included in the last qualified offer.

(3) *Liability pursuant to the judgment.* For purposes of paragraph (b)(1) of this section, the taxpayer's liability pursuant to the judgment is the change in the taxpayer's liability resulting from amounts contained in the judgment as a result of the court's determinations, and amounts contained in settlements not included in the judgment, that are attributable to all adjustments that were included in the last qualified offer compared to the amount shown on the return or returns (or as previously adjusted). This liability includes amounts attributable to adjustments included in the last qualified offer and settled by the parties prior to the entry of judgment regardless of whether those amounts are actually included in the judgment entered by the court. The taxpayer's liability pursuant to the judgment does not include amounts attributable to adjustments that are not included in the last qualified offer, even if those amounts are actually included in the judgment entered by the court.

The taxpayer's liability under the judgment is calculated without regard to adjustments that the parties have stipulated will be resolved in accordance with the outcome of a separate pending Federal, state, or other judicial or administrative proceeding. Furthermore, the taxpayer's liability pursuant to the judgment is calculated without regard to interest, unless the taxpayer's liability for, or entitlement to, interest is a contested issue in the administrative or court proceeding and is one of the adjustments included in the last qualified offer. Where adjustments raised by either party subsequent to the making of the last qualified offer are included in the judgment entered by the court, or are settled prior to the court proceeding, the taxpayer's liability pursuant to the judgment is calculated by treating the subsequently raised adjustments as if they had never been raised.

(c) *Qualified offer*—(1) *In general.* A qualified offer is defined in section 7430(g) to mean a written offer which—

- (i) Is made by the taxpayer to the United States during the qualified offer period;
- (ii) Specifies the offered amount of the taxpayer's liability (determined without regard to interest, unless interest is a contested issue in the proceeding);
- (iii) Is designated at the time it is made as a qualified offer for purposes of section 7430(g); and
- (iv) By its terms, remains open during the period beginning on the date it is made and ending on the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made.

(2) *To the United States.* (i) A qualified offer is made to the United States when it is delivered to the office or personnel within the Internal Revenue Service, Office of Appeals, Office of Chief Counsel (including field personnel) or Department of Justice that has jurisdiction over the tax matter at issue in the administrative or court proceeding. If those offices or persons are unknown to the taxpayer making the qualified offer, the taxpayer may deliver the offer to the appropriate office, as follows:

(A) If the taxpayer's initial pleading in a court proceeding has been answered, the taxpayer may deliver the offer to the office that filed the answer.

(B) If the taxpayer's petition in the Tax Court has not yet been answered, the taxpayer may deliver the offer to the Office of Chief Counsel, 1111 Constitution Avenue, NW., Washington, DC 20224.

(C) If the taxpayer's initial pleading in any Federal court, other than the Tax

Court, has not yet been answered, the taxpayer may deliver the offer to the Attorney General of the United States, 950 Pennsylvania Ave., NW., Washington, DC 20530-0001. For a suit brought in a United States district court, a copy of the offer should also be delivered to the United States Attorney for the district in which the suit was brought.

(D) In any other situation, the taxpayer may deliver the offer to the office that sent the taxpayer the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

(ii) Until an offer is received by the appropriate personnel or office under this paragraph (c)(2), it is not considered to have been made, with the following exception. If the offer is deposited in the United States mail, in an envelope or other appropriate wrapper, postage prepaid, properly addressed to the appropriate personnel or office under this paragraph (c)(2), the date of the United States postmark stamped on the cover in which the offer is mailed shall be deemed to be the date of receipt of that offer by the addressee. If any offer is deposited with a designated delivery service, as defined in section 7502(f)(2), in lieu of the United States mail, the provisions of section 7502(f)(1) shall apply in determining whether that offer qualifies for this exception.

(3) *Specifies the offered amount.* A qualified offer specifies the offered amount if it clearly specifies the amount for the liability of the taxpayer, calculated as set forth in paragraph (b)(2) of this section. The offer may be a specific dollar amount of the total liability or a percentage of the adjustments at issue in the proceeding at the time the offer is made. This amount must be with respect to all of the adjustments at issue in the administrative or court proceeding at the time the offer is made and only those adjustments. The specified amount must be an amount, the acceptance of which by the United States will fully resolve the taxpayer's liability, and only that liability (determined without regard to adjustments that the parties have stipulated will be resolved in accordance with the outcome of a separate pending Federal, state, or other judicial or administrative proceeding, or interest, unless interest is a contested issue in the proceeding) for the type or types of tax and the taxable year or years at issue in the proceeding. In cases involving multiple tax years, if adjustments in different tax years arise from separate and distinct issues such

that the resolution of issues in one or more tax years will not affect the taxpayer's liability in one or more of the other tax years in the proceeding, then a qualified offer may be made for less than all of the tax years involved. A qualified offer, however, must resolve all of the issues for the tax years covered by the offer and also must cover all tax years in the proceeding affected by those issues. A tax year (affected year) is affected by an issue if the treatment of the issue in another tax year involved in the proceeding necessarily affects the treatment of the issue in the affected year.

(4) *Designated at the time it is made as a qualified offer.* An offer is not a qualified offer unless it designates in writing at the time it is made that it is a qualified offer for purposes of section 7430(g). An offer made at a time when one or more adjustments not included in the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals have been raised by the taxpayer and remain unresolved, is not considered to be a qualified offer unless contemporaneously or prior to the making of the offer, the taxpayer has provided the United States with the substantiation and legal and factual arguments necessary to allow for informed consideration of the merits of those adjustments. For example, a taxpayer will be considered to have provided the United States with the necessary substantiation and legal and factual arguments if the taxpayer (or a recognized representative of the taxpayer described in § 601.502 of this chapter) participates in an Appeals office conference, participates in an Area Counsel conference, or confers with the Department of Justice, and at that time, discloses all relevant information. All relevant information includes, but is not limited to, the legal and factual arguments supporting the taxpayer's position on any adjustments raised by the taxpayer after the issuance of the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals. A taxpayer has disclosed all relevant information if the taxpayer has supplied sufficient information to allow informed consideration of the taxpayer's tax matter to the extent the information and its relevance were known or should have been known to the taxpayer at the time of the conference.

(5) *Remains open.* A qualified offer must, by its terms, remain open for acceptance by the United States from the date it is made, as defined in

paragraph (c)(2)(ii) of this section, until the earliest of the date it is rejected in writing by a person with authority to reject the offer, the date the trial begins, or the 90th day after being received by the United States. The offer, by its written terms, may remain open after the occurrence of one or more of the above-referenced events. Once made, the period during which a qualified offer remains open may be extended by the taxpayer prior to its expiration, but an extension cannot be used to make an offer meet the minimum period for remaining open required by this paragraph (c)(5).

(6) *Last qualified offer.* A taxpayer may make multiple qualified offers during the qualified offer period. For purposes of the comparison under paragraph (b) of this section, the making of a qualified offer supersedes any previously made qualified offers. In making the comparison described in paragraph (b) of this section, only the qualified offer made most closely in time to the end of the qualified offer period is compared to the taxpayer's liability under the judgment.

(7) *Qualified offer period.* To constitute a qualified offer, an offer must be made during the qualified offer period. The qualified offer period begins on the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent to the taxpayer. For this purpose, the date of the notice of claim disallowance will begin the qualified offer period in a refund case. If there has been no notice of claim disallowance in a refund case, the qualified offer period begins on the date on which the answer or other responsive pleading is filed with the court. The qualified offer period ends on the date which is thirty days before the date the case is first set for trial. In determining when the qualified offer period ends for cases in the Tax Court and other Federal courts using calendars for trial, a case will be considered set for trial on the date scheduled for the calendar call. A case may be removed from a trial calendar at any time. Thus, a case may be removed from a trial calendar before the date that precedes by thirty days the date scheduled for that trial calendar. The qualified offer period does not end until the case remains on a trial calendar on the date that precedes by 30 days the scheduled date of the calendar call for that trial session. The qualified offer period may not be extended beyond the periods set forth in this paragraph (c)(7), although the period during which a qualified offer remains open may extend

beyond the end of the qualified offer period.

(d) [Reserved]

(e) *Examples.* The following examples illustrate the provisions of this section:

*Example 1. Definition of a judgment.* The Internal Revenue Service (IRS) audits Taxpayer A for year X and issues a notice of proposed deficiency (30-day letter) proposing to disallow deductions 1, 2, 3, and 4. A files a protest and participates in a conference with the Internal Revenue Service Office of Appeals (Appeals). Appeals allows deduction 1, and issues a statutory notice of deficiency for deductions 2, 3, and 4. A's petition to the United States Tax Court for year X never mentions deduction 2. Prior to trial, A concedes deduction 3. After the trial, the Tax Court issues an opinion allowing A to deduct a portion of deduction 4. As used in paragraph (a) of this section, the term judgment means the cumulative determinations of the court concerning the adjustments at issue in the court proceeding. Thus, the term judgment does not include deduction 1 because it was never at issue in the court proceeding. Similarly, the term judgment does not include deduction 2 because it was not placed at issue by A in the court proceeding. Although deduction 3 was at issue in the court proceeding, it is not included in the term judgment because it was not determined by the court, but rather by concession or settlement. For purposes of section 7430(c)(4)(E), the term judgment only includes the portion of deduction 4 disallowed by the Tax Court.

*Example 2. Liability under the offer and liability under the judgment.* Assume the same facts as in *Example 1* except that A makes a qualified offer after the Appeals conference, which is not accepted by the IRS. A's offer is with respect to all adjustments at issue at that time. Those adjustments are deductions 2, 3, and 4. At the conclusion of the litigation, A's entitlement to an award based upon the qualified offer will depend, among other things, on a comparison of the change in A's liability for income tax for year X resulting from the judgment of the Tax Court with the change that would have resulted had the IRS accepted A's qualified offer. In making this comparison, the term judgment (as discussed in *Example 1*) is modified by including the amounts of settled or conceded adjustments that were at issue at the time the qualified offer was made. Any settled or conceded adjustments that were not at issue at the time the qualified offer was made, either because the settlement or concession occurred before the offer or because the adjustment was not raised until after the offer, are not included in the comparison. Thus, A's offer on deductions 2, 3, and 4 is compared with the change in A's liability resulting from the Tax Court's determination of deduction 4, and the concessions of issues 2 and 3 by A.

*Example 3. Offer must resolve full liability.* Assume the same facts as in *Example 2* except that A's offer after the Appeals conference explicitly states that it is only with respect to adjustments 2 and 3 and not with respect to adjustment 4. Even if A's liability pursuant to the judgment, calculated

under paragraph (b)(3) of this section as illustrated in *Example 2*, is equal to or less than it would have been had the IRS accepted A's offer after the Appeals conference, A is not a prevailing party under section 7430(c)(4)(E). A qualified offer must include all adjustments at issue at the time the offer is made. Since A's offer excluded adjustment 4, which was an adjustment at issue at the time the offer was made, it does not constitute a qualified offer pursuant to paragraph (b)(2) of this section.

*Example 4. Offer must resolve full liability.* Assume the same facts as in *Example 1*, except that A makes a qualified offer that is accepted by the IRS. After the offer is accepted, A attempts to reduce the amount A will pay pursuant to the offer by applying net operating loss carryovers to the years in issue. Because the net operating losses were not at issue when the offer was made, A's offer was a qualified offer. Whether A is entitled to apply net operating losses to reduce the amount stated in the offer will depend upon the application of contract principles, local court rules, and, because net operating losses are at issue, section 6511(d) and related provisions.

*Example 5. Qualified offer rule for multiple tax years, partial resolution offer is a qualified offer.* Taxpayer B receives a notice of deficiency for taxable years 2001, 2002, and 2003. For 2001, the statutory notice disallows business deductions. For 2002, the statutory notice increases income for unreported lottery winnings. For 2003, the statutory notice disallows a child care credit. B submits a qualified offer only with respect to 2002. Since the adjustments for the three tax years are separate and distinct, B may submit a qualified offer for a single year. If B's liability under the judgment is equal to or less than the qualified offer with respect to 2002, irrespective of 2001 and 2003, B is a prevailing party for 2002 for purposes of section 7430(g). Assuming B satisfies the remaining requirements of section 7430, B may recover reasonable administrative and litigation costs that are attributable to 2002 from the date of the qualified offer. To qualify for any costs with respect to 2001 or 2003, B must satisfy the requirements of section 7430(c)(4).

*Example 6. Qualified offer rule for multiple tax years, partial resolution offer is not a qualified offer.* Assume the same facts as in *Example 5* except that with respect to 2002, in addition to increasing B's income for the unreported lottery winnings, the statutory notice also disallows a charitable contribution deduction. B submits a settlement offer that purports to be a qualified offer, but only covers the unreported lottery winnings. B's offer is not a qualified offer because it does not address the charitable contribution issue, and thus, does not fully resolve B's liability for 2002.

*Example 7. Qualified offer rule for multiple tax years, partial resolution offer is not a qualified offer.* Taxpayer C receives a notice of deficiency for taxable years 2001, 2002, and 2003 adjusting the amount of a depreciation deduction due to the Internal Revenue Service's increase to the recovery period. C submits a settlement offer relating only to 2003 that purports to be a qualified

offer. C's offer is not a qualified offer because the issue in the three tax years is not separable given that the treatment of the issue in one of the years necessarily affects the treatment of the issue in the other years, and C's offer only applies to one of the years in the proceeding. In cases involving multiple tax years with nonseparable tax issues affecting all tax years, an offer is not a qualified offer unless it resolves the liability for all tax years at issue in the administrative or judicial proceeding.

*Example 8. Qualified offer rule inapplicable when all issues settled.* Taxpayer D receives a notice of proposed deficiency (30-day letter) proposing to disallow both a personal interest deduction in the amount of \$10,000 (Adjustment 1), and a charitable contribution deduction in the amount of \$2,000 (Adjustment 2), and to include in income \$4,000 of unreported interest income (Adjustment 3). D timely files a protest with Appeals. At the Appeals conference, D presents substantiation for the charitable contribution and presents arguments that the interest paid was deductible mortgage interest and that the interest received was held in trust for Taxpayer E. At the conference, D also provides the Appeals officer assigned to D's case a written offer to settle the case for a deficiency of \$2,000, exclusive of interest. The offer states that it is a qualified offer for purposes of section 7430(g) and that it will remain open for acceptance by the IRS for a period in excess of 90 days. After considering D's substantiation and arguments, the Appeals Officer accepts the \$2,000 offer to settle the case in full. Although D's offer is a qualified offer, because all three adjustments contained in the qualified offer were settled, the qualified offer rule is inapplicable.

*Example 9. Qualified offer rule inapplicable when all issues contained in the qualified offer are settled; subsequently raised adjustments ignored.* Assume the same facts as in *Example 8* except that D's qualified offer was for a deficiency of \$1,800 and the IRS rejected that offer. Subsequently, the IRS issued a statutory notice of deficiency disallowing the three adjustments contained in *Example 8*, and, in addition, disallowing a home office expense in the amount of \$5,000 (Adjustment 4). After petitioning the Tax Court, D presents the field attorney assigned to the case with a written offer, which is not designated as a qualified offer for purposes of section 7430(g), to settle the three adjustments that had been the subject of the qualified offer, plus adjustment 4, for a total deficiency of \$2,500. After negotiating with D, a settlement is reached on the three adjustments that were the subject of the rejected qualified offer, for a deficiency of \$1,800. Adjustment 4 is litigated in the Tax Court and the court determines that D is entitled to the full \$5,000 deduction for that adjustment. Consequently, a decision is entered by the Tax Court reflecting the \$1,800 settlement amount, which matches exactly the amount of D's only qualified offer in the case. Although the determined liability for adjustments 1, 2, and 3 equals that of the rejected qualified offer, because all three adjustments contained in the qualified offer

were settled, the qualified offer rule is inapplicable.

**Example 10. Exclusion of adjustments made after the qualified offer is made.** Assume the same facts as in *Example 9* except the settlement is reached only on adjustments 1 and 2, for a liability of \$1,500. Adjustments 3 and 4 are tried in the Tax Court and in accordance with the court's opinion, the taxpayer has a \$300 deficiency attributable to adjustment 3, and a \$1,550 deficiency attributable to adjustment 4. Consequently, a decision is entered reflecting the \$1,500 settled amount, the \$300 liability on adjustment 3, and the \$1,550 liability on adjustment 4. The \$3,350 deficiency reflected in the Tax Court's decision exceeds the last (and only) qualified offer made by D. For purposes of determining whether D is a prevailing party as a result of having made a qualified offer in the proceeding, the liability attributable to adjustment 4, which was raised after the last qualified offer was made, is not included in the comparison of D's liability under the judgment with D's offered liability under the last qualified offer. Thus, D's \$1,800 liability under the judgment, as modified for purposes of the qualified offer rule comparison, is equal to D's offered liability under the last qualified offer. Because D's liability under the last qualified offer equals or exceeds D's liability under the judgment, as calculated under paragraph (b)(3) of this section, D is a prevailing party for purposes of section 7430. Assuming D satisfies the remaining requirements of section 7430, D may recover those reasonable administrative and litigation costs attributable to adjustment 3. To qualify for any further award of reasonable administrative and litigation costs, D must satisfy the requirements of section 7430(c)(4)(A).

**Example 11. Qualified offer in a refund case.** Taxpayer E timely files an amended return claiming a refund of \$1,000. This refund claim results from several omitted deductions which, if allowed, would reduce E's tax liability from \$10,000 to \$9,000. E receives a notice of claim disallowance and files a complaint with the appropriate United States District Court. Subsequently, E makes a qualified offer for a refund of \$500. The offer is rejected and after trial the court finds E is entitled to a refund of \$700. The change in E's liability from the tax shown on the return that would have resulted from the acceptance of E's qualified offer is a reduction in that liability of \$500. The change in E's liability from the tax shown on the return resulting from the judgment of the court is a reduction in that liability of \$700. Because E's liability under the qualified offer exceeds E's liability under the judgment, E is a prevailing party for purposes of section 7430. Assuming E satisfies the remaining requirements of section 7430, E may recover those reasonable litigation costs incurred on or after the date of the qualified offer. To qualify for any further award of reasonable administrative and litigation costs E must satisfy the requirements of section 7430(c)(4)(A).

**Example 12. End of qualified offer period when case is removed from Tax Court trial calendar more than 30 days before scheduled**

*trial calendar.* Taxpayer F has petitioned the Tax Court in response to the issuance of a notice of deficiency. F receives notice that the case will be heard on the July trial session in F's city of residence. The scheduled date for the calendar call for that trial session is July 1st. On May 15th, F's motion to remove the case from the July trial session and place it on the October trial session for that city is granted. The scheduled date for the calendar call for the October trial session is October 1st. On May 31st, F delivers a qualified offer to the field attorney assigned to the case. On August 31st, F delivers a revised qualified offer to the field attorney assigned to the case. Neither offer is accepted. The case is tried during the October trial session, and at some time thereafter, a decision is entered by the court. Assume the judgment in the case, as calculated under paragraph (b)(3) of this section, is greater than the amount offered, as calculated under paragraph (b)(2) of this section, in the qualified offer delivered on May 31st, but less than the amount offered, as similarly calculated, in the qualified offer delivered on August 31st. Because the qualified offer period did not end until September 1st, and the offer of August 31st otherwise satisfied the requirements of paragraph (c) of this section, the offer delivered on August 31st is a qualified offer. Furthermore, because the August 31st qualified offer is closer in time to the end of the qualified offer period than the May 31st qualified offer, the August 31st qualified offer is the last qualified offer made by F. Consequently, the August 31st offer is the qualified offer that is compared to the judgment for purposes of determining whether F is a prevailing party under section 7430(c)(4)(E). Because F's liability under the August 31st qualified offer equals or exceeds F's liability under the judgment as calculated under paragraph (b)(3) of this section, F is a prevailing party for purposes of section 7430.

**Example 13. End of qualified offer period when case is removed from Tax Court trial calendar less than 30 days before scheduled trial calendar.** Assume the same facts as in *Example 12* except that F's motion was granted on June 15th. Because the qualified offer period ended on June 1st when the case remained on the July trial session on the date that preceded by 30 days the scheduled date of the calendar call for that trial session, the offer delivered on May 31st was F's last qualified offer. The August 31st offer is not a qualified offer for purposes of this rule. Consequently, F is not a prevailing party under the qualified offer rule. Therefore, F must satisfy the requirements of section 7430(c)(4)(A) to qualify for any award of reasonable administrative and litigation costs.

**Example 14. When a qualified offer can be made and to whom it must be made.** During the examination of Taxpayer G's return, the IRS issues a notice of deficiency without having first issued a 30-day letter. After receiving the notice of deficiency G timely petitions the Tax Court. The next day G mails an offer to the office that issued the notice of deficiency, which offer satisfies the requirements of paragraphs (c)(3) through (6) of this section. This is the only written offer

made by G during the administrative or court proceeding, and by its terms it is to remain open for a period in excess of 90 days after the date of mailing to the office issuing the notice of deficiency. The office that issued the notice of deficiency transmitted the offer to the field attorney with jurisdiction over the Tax Court case. After answering the case, the field attorney refers the case to Appeals pursuant to Rev. Proc. 87-24 (1987-1 C.B. 720). See § 601.601(d)(2)(ii)(b) of this chapter. After careful consideration, Appeals rejects the offer and holds a conference with G during which some adjustments are settled. The remainder of the adjustments are tried in the Tax Court and G's liability resulting from the Tax Court's determinations, when added to G's liability resulting from the settled adjustments, is less than G's liability would have been under the offer rejected by Appeals. Because the Tax Court case had not yet been answered when the offer was sent, G properly mailed the offer to the office that issued the notice of deficiency. Thus, G's offer satisfied the requirements of paragraph (c)(2) of this section. Furthermore, even though G did not receive a 30-day letter, G's offer was made after the beginning of the qualified offer period, satisfying the requirements of paragraph (c)(7) of this section, because the issuance of the statutory notice provided G with notice of the IRS's determination of a deficiency, and the docketing of the case provided G with an opportunity for administrative review in the Internal Revenue Service Office of Appeals under Rev. Proc. 87-24. See § 601.601(d)(2)(ii)(b) of this chapter. Because G's offer satisfied all of the requirements of paragraph (c) of this section, the offer was a qualified offer and G is a prevailing party.

**Example 15. Substitution of parties permitted under last qualified offer.** Taxpayer H receives a 30-day letter and participates in a conference with the Office of Appeals but no agreement is reached. Subsequently, H receives a notice of deficiency and petitions the Tax Court. Upon receiving the Internal Revenue Service's answer to the petition, H sends a qualified offer to the field attorney who signed the answer, by United States mail. The qualified offer stated that it would remain open for more than 90 days. Thirty days after making the offer, H dies and, on motion under Rule 63(a) of the Tax Court's Rules of Practice and Procedure by H's personal representative, I is substituted for H as a party in the Tax Court proceeding. I makes no qualified offers to settle the case and the case proceeds to trial, with the Tax Court issuing an opinion partially in favor of I. Even though I was not a party when the qualified offer was made by H, that offer constitutes a qualified offer because by its terms, when made, it was to remain open until at least the earlier of the date it is rejected, the date of trial, or 90 days. If the liability of I under the qualified offer, as determined under paragraph (b)(2) of this section, equals or exceeds the liability under the judgment of the Tax Court, as determined under paragraph (b)(3) of this section, I will be a prevailing party for purposes of an award of reasonable litigation costs under section 7430.

(g) *Effective date.* This section is applicable with respect to qualified offers made in administrative or court proceedings described in section 7430 after December 24, 2003.

**§ 301.7430–7T [Removed]**

■ **Par. 3.** Section 301.7430–7T is removed.

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

Approved: December 19, 2003.

**Pamela F. Olson,**

*Assistant Secretary of the Treasury.*

[FR Doc. 03–31822 Filed 12–24–03; 8:45 am]

BILLING CODE 4830–01–P

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## DEPARTMENT OF JUSTICE

### 28 CFR Part 28

[OAG 101; AG Order No. 2699–2003]

RIN 1105–AA78

#### Regulations Under the DNA Analysis Backlog Elimination Act of 2000

**AGENCY:** Department of Justice.

**ACTION:** Final rule.

**SUMMARY:** The Department of Justice is publishing this final rule to implement section 3 and related provisions of the DNA Analysis Backlog Elimination Act of 2000, as amended by the USA PATRIOT Act. The rule specifies the Federal offenses that will be treated as qualifying offenses for purposes of collecting DNA samples from Federal offenders, sets forth the responsibilities of the Federal Bureau of Prisons for collecting DNA samples from individuals in its custody, and sets forth related responsibilities of the Federal Bureau of Investigation for analyzing and indexing DNA samples.

**DATES:** *Effective date:* This rule is effective January 28, 2004.

**FOR FURTHER INFORMATION CONTACT:**

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**SUPPLEMENTARY INFORMATION:** All 50 states authorize the collection and analysis of DNA samples from convicted State offenders, and entry of resulting information into the Combined DNA Index System (“CODIS”), which the Federal Bureau of Investigation (“FBI”) has established pursuant to 42 U.S.C. 14132. The DNA Analysis Backlog Elimination Act of 2000 (the “Act”), Public Law 106–546, similarly authorized the collection, analysis, and indexing of DNA samples from

convicted Federal, military, and District of Columbia offenders.

Section 3 of the Act addresses the offenses that are to be treated as qualifying Federal offenses for purposes of DNA sample collection, which determines the categories of Federal offenders from whom DNA samples are collected. Section 3 also addresses the responsibility of the Federal Bureau of Prisons (“BOP”) and federal probation offices to collect DNA samples from offenders in their custody or supervision, and the responsibility of the FBI to analyze and index DNA samples. On June 28, 2001, the Department of Justice published an interim rule in the **Federal Register**, pursuant to subsection (e) of section 3, which provides that, with the exception of the activities of the probation offices, the section shall be carried out under regulations prescribed by the Attorney General. See 66 FR 34363 (June 28, 2001). The interim rule also addressed certain responsibilities of BOP and the FBI under other sections of the Act that are closely related to the matters addressed in section 3.

Subsequent to the publication of the interim rule, Congress enacted Public Law 107–56, the USA PATRIOT Act. Section 503 of the USA PATRIOT Act provided that three additional categories of offenses shall be treated for purposes of DNA sample collection as qualifying Federal offenses, as determined by the Attorney General: (1) Any offense listed in section 2332b(g)(5)(B) of title 18, United States Code; (2) any crime of violence (as defined in section 16 of title 18, United States Code); and (3) any attempt or conspiracy to commit any of the above offenses. See 42 U.S.C. 14135a(d)(2). The Department of Justice published a proposed rule in the **Federal Register** on March 11, 2003, to implement this expanded sample collection authority. See 68 FR 11481 (March 11, 2003).

The Department received comments from two individuals concerning the interim rule published on June 28, 2001. No comments were received concerning the proposed rule published on March 11, 2003. One commenter on the interim rule claimed that the rule violated numerous provisions of the Constitution. The other commenter asked about the relationship of the interim rule to statute of limitations provisions and its consistency with the Constitution’s prohibition of ex post facto laws. The Department of Justice has considered the constitutional question and is confident that the interim rule, the proposed rule, this final rule, and the statutory provisions that they implement, are consistent with

the Constitution. See, e.g., *United States v. Kimler*, 335 F.3d 1132 (10th Cir. 2003); *Shaffer v. Saffle*, 148 F.3d 1180 (10th Cir. 1998); *Rise v. Oregon*, 59 F.3d 1556 (9th Cir. 1995); *Gilbert v. Peters*, 55 F.3d 237 (7th Cir. 1995); *Jones v. Murray*, 962 F.2d 302 (4th Cir. 1992). But see *United States v. Kincaide*, 345 F.3d 1095 (9th Cir. 2003). These rules have no effect on the statutory limitation periods for commencing the prosecution of crimes.

The interim rule published on June 28, 2001, added a new part 28 to title 28 CFR relating to the DNA identification system. The proposed rule published on March 11, 2003, involved a modification of § 28.2 in the new part 28, to reflect the expanded range of qualifying federal offenses authorized by section 503 of the USA PATRIOT Act. This final rule integrates the proposed rule’s revision of § 28.2 with the other regulatory provisions adopted by the interim rule. The list of offenses in the final version of § 28.2 is generally the same as in the proposed rule, but includes two additional offenses (18 U.S.C. 2332f and 2339C) that appear in the listing of 18 U.S.C. 2332b(g)(5)(B), as discussed below. In addition, some citations have been updated or added for conformity to the current versions of the cited statutes, or to ensure consistent coverage of attempts and conspiracies to commit offenses that are otherwise covered. The changes affect specifically the citations relating to provisions of 18 U.S.C. 43, 1512, 1513, and 1594, and also involve substituting citations relating to 40 U.S.C. 5104 and 5109 for former citations relating to 40 U.S.C. 193f and 193h.

Like the interim rule published on June 28, 2001, this final rule sets forth a part 28 of title 28 CFR relating to the DNA identification system. Part 28 contains subparts A and B, which relate respectively to the federal offenses for which DNA samples will be collected, and the responsibilities of BOP and the FBI in collecting, analyzing, and indexing DNA samples:

#### Subpart A—Qualifying Federal Offenses for Purposes of DNA Sample Collection

Subpart A of the rule specifies qualifying federal offenses for purposes of DNA sample collection. Section 3 of the Act, in part, requires BOP and probation offices to collect DNA samples from individuals in their custody or supervision who are, or have been, convicted of a “qualifying Federal offense.” Subsection (d)(1) of section 3 of the Act states that qualifying Federal offenses include those in a specified list, as determined by the Attorney General.