

(d) *Payment of tax.* Any increase in tax caused by including the LIFO recapture amount or the lookthrough LIFO recapture amount in the gross income of the C corporation is payable in four equal installments. The C corporation must pay the first installment of this payment by the due date of its return, determined without regard to extensions, for the last taxable year it operated as a C corporation if paragraph (a)(1) or (b)(1) of this section applies, or for the taxable year of the transfer if paragraph (a)(2) or (b)(2) of this section applies. The three succeeding installments must be paid—

(1) For a transaction described in paragraph (a)(1) or (b)(1) of this section, by the corporation that made the election under section 1362(a) to be an S corporation, on or before the due date for the corporation's returns (determined without regard to extensions) for the succeeding three taxable years; and

(2) For a transaction described in paragraph (a)(2) or (b)(2) of this section, by the transferee S corporation on or before the due date for the transferee corporation's returns (determined without regard to extensions) for the succeeding three taxable years.

(e) *Basis adjustments*—(1) *General rule.* Appropriate adjustments to the basis of inventory are to be made to reflect any amount included in income under paragraph (a) of this section.

(2) *LIFO inventory owned through a partnership*—(i) *Basis of corporation's partnership interest.* Appropriate adjustments to the basis of the corporation's lookthrough partnership interest are to be made to reflect any amount included in income under paragraph (b) of this section.

(ii) *Basis of partnership assets.* A partnership directly holding LIFO inventory that is taken into account under paragraph (b) may elect to adjust the basis of that LIFO inventory. In addition, a partnership that holds, through another partnership, LIFO inventory that is taken into account under paragraph (b) may elect to adjust the basis of that partnership interest. Any adjustment under this paragraph (e)(2) to the basis of inventory held by the partnership is equal to the amount of LIFO recapture attributable to the inventory. Likewise, any adjustment under this paragraph (e)(2) to the basis of a lookthrough partnership interest held by the partnership is equal to the amount of LIFO recapture attributable to the interest. A basis adjustment under this paragraph (e)(2) is treated in the same manner and has the same effect as an adjustment to the basis of

partnership property under section 743(b). See § 1.743-1(j).

(3) *Election.* A partnership elects to adjust the basis of its inventory and any lookthrough partnership interest that it owns by attaching a statement to its original or amended income tax return for the first taxable year ending on or after the date of the S corporation election or transfer described in paragraph (b) of this section. This statement shall state that the partnership is electing under § 1.1363-2(e)(3) and must include the names, addresses, and taxpayer identification numbers of any corporate partner liable for tax under paragraph (d) of this section and of the partnership, as well as the amount of the adjustment and the portion of the adjustment that is attributable to each pool of inventory or lookthrough partnership interest that is held by the partnership.

(f) *Examples.* The following examples illustrate the rules of this section.

*Example 1.* (i) G is a C corporation with a taxable year ending on June 30. GH is a partnership with a calendar year taxable year. G has a 20 percent interest in GH. The remaining 80 percent interest is owned by an individual. On April 25, 2005, G contributed inventory that is LIFO inventory to GH, increasing G's interest in the partnership to 50 percent. GH holds no other LIFO inventory. G elects to be an S corporation effective July 1, 2005. The recapture date is June 30, 2005 under paragraph (c)(3) of this section. GH determines that the FIFO and LIFO values of the opening inventory for GH's 2005 taxable year, including the inventory contributed by G, are \$200 and \$120, respectively.

(ii) Under paragraph (c)(1) of this section, GH is not required to determine the FIFO and LIFO values of the inventory on the recapture date. Instead, GH may determine the lookthrough LIFO recapture amount as though the FIFO and LIFO values of the inventory on the recapture date equaled the FIFO and LIFO values of the opening inventory for the partnership's taxable year (2005) that includes the recapture date. For this purpose, under paragraph (c)(2) of this section, the opening inventory includes the inventory contributed by G. The amount by which the FIFO value (\$200) exceeds the LIFO value (\$120) in GH's opening inventory is \$80. Thus, if GH sold all of its LIFO inventory for \$200, it would recognize \$80 of income. G's lookthrough LIFO recapture amount is \$80, the amount of income that would be allocated to G, taking into account section 704(c) and § 1.704-3, if GH sold all of its LIFO inventory for the FIFO value. Under paragraph (b)(1) of this section, G must include \$80 in income in its taxable year ending on June 30, 2005. Under paragraph (e)(2) of this section, G must increase its basis in its interest in GH by \$80. Under paragraphs (e)(2) and (3) of this section, and in accordance with section 743(b) principles, GH may elect to increase the basis (with respect to G only) of its LIFO inventory by \$80.

*Example 2.* (i) J is a C corporation with a calendar year taxable year. JK is a partnership with a calendar year taxable year. J has a 30 percent interest in the partnership. JK owns LIFO inventory that is not section 704(c) property. J elects to be an S corporation effective January 1, 2005. The recapture date is December 31, 2004 under paragraph (c)(3) of this section. JK determines that the FIFO and LIFO values of the inventory on December 31, 2004 are \$240 and \$140, respectively.

(ii) The amount by which the FIFO value (\$240) exceeds the LIFO value (\$140) on the recapture date is \$100. Thus, if JK sold all of its LIFO inventory for \$240, it would recognize \$100 of income. J's lookthrough LIFO recapture amount is \$30, the amount of income that would be allocated to J if JK sold all of its LIFO inventory for the FIFO value (30 percent of \$100). Under paragraph (b)(1) of this section, J must include \$30 in income in its taxable year ending on December 31, 2004. Under paragraph (e)(2) of this section, J must increase its basis in its interest in JK by \$30. Under paragraphs (e)(2) and (3) of this section, and in accordance with section 743(b) principles, JK may elect to increase the basis (with respect to J only) of its inventory by \$30.

(g) *Effective dates.* \* \* \*

(3) The provisions of paragraphs (b), (c), (e)(2), (e)(3), and (f) of this section apply to S elections and transfers made on or after August 13, 2004.

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

[FR Doc. 04-18559 Filed 8-12-04; 8:45 am]

BILLING CODE 4830-01-P

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-131264-04]

RIN 1545-BD55

### Consolidated Returns; Intercompany Transactions

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

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations that provide guidance regarding the treatment of manufacturer incentive payments between members of a consolidated group. The proposed regulations are necessary to provide additional guidance for a variety of transactions involving manufacturer incentive payments. The regulations will affect corporations filing consolidated returns.

**DATES:** Written or electronic comments and requests for a public hearing must be received by November 12, 2004.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-131264-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-131264-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically, via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS and REG-131264-04).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Frances Kelly, (202) 622-7770; concerning submissions of comments and/or requests for a public hearing, Treena Garrett, (202) 622-7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background and Explanation of Provisions**

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 1502 of the Internal Revenue Code. On July 18, 1995, final regulations (TD 8597) under § 1.1502-13, amending the intercompany transaction system of the consolidated return regulations, were published in the **Federal Register** (60 FR 36671). Those final regulations provide rules for taking into account items of income, gain, deduction, and loss of members from intercompany transactions. Their purpose is to clearly reflect the taxable income (and tax liability) of the group by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income or consolidated tax liability.

*Accounting for Intercompany Transactions*

Under § 1.1502-13(b)(1), an intercompany transaction is a transaction between corporations that are members of the same consolidated group immediately after the transaction. For purposes of § 1.1502-13, S is the member transferring property or providing services, and B is the member receiving the property or services.

S's income, gain, deduction, and loss from an intercompany transaction, whether directly or indirectly, are its intercompany items, and may include amounts from an intercompany transaction that are not yet taken into account under its separate entity method of accounting. B's income, gain,

deduction, and loss from an intercompany transaction, or from property acquired in an intercompany transaction, are its corresponding items. An item is a corresponding item whether it is directly or indirectly from an intercompany transaction (or from property acquired in an intercompany transaction). The recomputed corresponding item is the corresponding item that B would take into account if S and B were divisions of a single corporation and the intercompany transaction were between those divisions. Although neither S nor B actually takes the recomputed corresponding item into account, it is computed as if B did take it into account.

*Matching Rule*

In general, under the matching rule of § 1.1502-13(c), B takes its corresponding item into account under its separate entity accounting method and S takes its intercompany item into account to reflect the difference for the year between B's corresponding item taken into account and the recomputed corresponding item. The matching rule determines when the intercompany transaction regulations override the members' timing of items under their otherwise applicable separate entity methods of accounting.

*Manufacturer Incentive Payments*

Section 1.1502-13(c)(7)(ii), *Example 13*, illustrates how the matching rule of the intercompany transaction regulations treats manufacturer incentive payments made by one member of a group to another. In this example, B is a manufacturer that sells its products to dealers, and S is a credit company that offers financing, including financing to customers of the dealers. Under B's incentive program, in Year 1, S purchases the product from an independent dealer for \$100 and leases it to a nonmember. S pays \$90 to the dealer for the product, and assigns to the dealer its \$10 incentive payment from B. Under their separate entity accounting methods, B would deduct the \$10 incentive payment in Year 1 and S would take a \$90 basis in the product. The example assumes that if S and B were divisions of a single corporation, the \$10 payment would not be deductible and S's basis in the property would be \$100. The example concludes that under the matching rule of § 1.1502-13(c), S takes its \$10 intercompany item into account as income in Year 1 to reflect the difference between B's \$10 corresponding item (the \$10 deduction taken into account by B) and the \$0

recomputed corresponding item. S's basis in the product is \$100 (rather than the \$90 it would be under S's separate entity method of accounting) and the additional \$10 of basis in the product is recovered based on subsequent events (e.g., S's cost recovery deductions or its sale of the product).

Since § 1.1502-13 was issued, it has become clear that the facts and the underlying assumptions in *Example 13* do not provide adequate guidance to address the variety of transactions involving manufacturer incentive payments. Accordingly, the IRS and Treasury Department believe that § 1.1502-13(c)(7)(ii), *Example 13*, should be amended to address certain of these transactions and to clarify the proper treatment of such payments under the intercompany transaction regulations. Therefore, these proposed regulations supplement the fact pattern of *Example 13* with two additional fact patterns involving manufacturer incentive payments.

**Proposed Effective Date**

The regulations are proposed to apply to any consolidated return year for which the due date of the income tax return (without regard to extensions) is on or after the date that is sixty days after the date these regulations are filed as final regulations with the **Federal Register**.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rule making will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are

submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

**Drafting Information**

The principal author of these proposed regulations is William F. Barry, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

**PART 1—INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \* Section 1.1502-13 also issued under 26 U.S.C. 1502. \* \* \*

**Par. 2.** Section 1.1502-13 is amended by adding paragraph (c)(7)(ii), *Example 13*(c), (d), and (e), and paragraph (c)(7)(iii) to read as follows:

**§ 1.1502-13 Intercompany transactions.**

\* \* \* \* \*

- (c) \* \* \*
- (7) \* \* \*
- (ii) \* \* \*

*Example 13.* \* \* \*

(c) *Deduction for incentive payment on single entity basis.* B is a manufacturer that sells its products to independent dealers for resale. S is a credit company that offers financing, including financing to customers of the independent dealers. During Year 1, B initiates a program of incentive payments. Under B's program, an independent dealer sells product to a customer under a retail installment sales contract (RISC) in which the customer agrees to pay for the product over the term of the contract at a below market interest rate. The customer purchases the product from the independent dealer and enters into a RISC. The RISC has a face amount of \$100 but a fair market value of \$90. The independent dealer assigns the RISC to S in exchange for a \$100 payment from S. B pays \$10 to S to compensate S for

the \$10 overpayment to the independent dealer. Assume that under their respective separate entity accounting methods, B would deduct the \$10 payment in Year 1, and S would take a \$90 basis in the RISC and would take the \$10 into account over the term of the RISC. Assume that, if S and B were divisions of a single corporation, the \$10 overpayment to the independent dealer would be deductible in Year 1 and the basis of the RISC would be \$90.

(d) *Timing and attributes.* Under paragraph (b)(1) of this section, the incentive payment transaction is an intercompany transaction. Under paragraph (b)(2)(iii) of this section, S has a \$10 intercompany item not yet taken into account under its separate entity method of accounting. Under the matching rule, S takes its intercompany item into account to reflect the difference between B's corresponding item taken into account and the recomputed corresponding item. In Year 1, there is no difference between B's \$10 deduction taken into account and the \$10 recomputed deduction. Accordingly, under the matching rule, S does not take the \$10 incentive payment into account as intercompany income in Year 1. Instead, S takes the \$10 into income over the term of the RISC. S's basis in the RISC is \$90.

(e) *No intercompany transaction.* B is a manufacturer that sells its products to independent dealers for resale. S is a credit company that offers financing to purchasers of goods and services, including the independent dealers. During Year 1, B initiates a program of incentive payments to the independent dealers. Under B's program, S loans \$100 to an independent dealer at a below market interest rate to finance the independent dealer's purchase of product from B. The independent dealer issues a note to S at a below market interest rate. B pays \$10 to S to compensate S for the below market interest rate on the note. Under § 1.1273-2(g)(4), the payment from B to S is treated as a payment from B to the independent dealer and then as a payment from the independent dealer to S. Because the incentive payment is treated as being made by a member of the group to a nonmember, the transaction is not an intercompany transaction under paragraph (b)(1) of this section. Therefore, § 1.1502-13 is not applicable.

\* \* \* \* \*

(iii) *Effective date.* Paragraphs (c), (d), and (e) of this *Example 13* are proposed to apply to any consolidated return year for which the due date of the income tax return (without regard to extensions) is on or after the date that is sixty days after the date these regulations are filed as final regulations with the **Federal Register**.

\* \* \* \* \*

**Mark E. Matthews,**  
*Deputy Commissioner for Services and Enforcement.*  
[FR Doc. 04-18557 Filed 8-12-04; 8:45 am]  
**BILLING CODE 4830-01-P**

**ENVIRONMENTAL PROTECTION AGENCY**

**40 CFR Parts 156 and 165**

[OPP-2004-0049; FRL-7674-4]

RIN 2070-AB95

**Standards for Pesticide Containers and Containment; Extension of Comment Period**

**AGENCY:** Environmental Protection Agency (EPA).

**ACTION:** Proposed rule; extension of comment period.

**SUMMARY:** EPA issued a notice in the **Federal Register** of June 30, 2004 to reopen the comment period for the 1994 proposed rule on pesticide containers and containment structures to solicit public input on issues or technology that would not have been available or could not have been addressed during previous public comment opportunities. This document is extending the comment period for 30 days beyond the current August 16, 2004 deadline.

**DATES:** Comments, identified by docket identification (ID) number OPP-2004-0049 must be received on or before September 15, 2004.

**ADDRESSES:** Follow the detailed instructions for submitting comments as provided in the **ADDRESSES** section of the **Federal Register** document of June 30, 2004 (OPP-2004-0049; 69 FR 39392). In addition, comments may be submitted through the Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the online instructions for submitting comments.

**FOR FURTHER INFORMATION CONTACT:** Nancy Fitz, Field and External Affairs Division, (7506C), Office of Pesticide Programs, Environmental Protection Agency, 1200 Pennsylvania Ave., NW., Washington, DC 20460-0001; telephone number: (703) 305-7385; fax number: (703) 308-3259; e-mail address: [fitz.nancy@epa.gov](mailto:fitz.nancy@epa.gov).

**SUPPLEMENTARY INFORMATION:**

**I. General Information**

*A. Does This Action Apply to Me?*

The Agency included in the proposed rule and the supplemental notice a list of those who may be potentially affected by this action. If you have questions regarding the applicability of this action to a particular entity, consult the person listed under **FOR FURTHER INFORMATION CONTACT**.